

ARE THE FINANCIAL RECORDS OF THE FEDERAL GOVERNMENT RELIABLE?

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS

OF THE
COMMITTEE ON
GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

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FRIDAY, MARCH 30, 2001

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL
MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Putnam.

Staff present: J. Russell George, staff director and chief counsel; Dianne Guensberg, detailee; Bonnie Heald, director of communications; Earl Pierce, professional staff member; Matthew Ebert, policy advisor; Grant Newman, assistant to the committee; Brian Homm, intern; Mark Stephenson, minority professional staff member; and Jean Gosa, minority clerk.

Mr. HORN. The first hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

We are here today to examine the executive branch of the Federal Government's progress in accounting for the billions of taxpayer dollars it spends each year. Those billions now add up to trillions of taxpayer dollars.

For the record, it should be clear that the previous President and Cabinet are responsible for the balance sheets that are before us. The General Accounting Office and the subcommittee staff have reviewed all of the audits.

Throughout the past decade, Congress has sought ways to make the executive branch of the Federal Government financially accountable to the Nation's taxpayers. In 1990, Congress approved, and the President signed into law the Chief Financial Officers Act. This law established the position of chief financial officer in each of the 24 major executive branch departments and agencies. Similar to chief financial officers in the private sector, the government's chief financial officers are responsible for the overall financial management of their respective agencies.

In 1997, the Chief Financial Officers Act was amended to require the 24 major Federal agencies to prepare annual audited financial statements by March 1st following the end of the government's fiscal year on September 30th. In addition, the amended law requires the Department of the Treasury to prepare annual consolidated governmentwide financial statements.

The General Accounting Office is headed by the very able Comptroller General of the United States, Mr. Walker. It audits and reports on these statements by March 31st.

The General Accounting Office's most recent report for fiscal year 2000 is being released today. Based on the GAO report, the General Accounting Office and agency auditors' findings, the subcommittee is also releasing its report card today grading the 24 agencies on their progress in improving their financial management. The ultimate goal is to provide reliable information on program costs and benefits. This will allow decisionmakers to determine accurately the value of Federal programs and whether they are worth the cost to the taxpayers.

The first step in the process, of course, is to know the cost. Although agencies have made progress since their first attempt to prepare financial statements in 1998, we are still a long way from achieving that basic goal. Each year an increasing number of agencies have been able to produce clean auditable financial statements. This progress was often achieved through very difficult efforts.

This year, for the first time, all 24 agencies managed to file these statements by the March 1st deadline. Also, this year the number of agencies receiving clean audit opinions has risen. Nevertheless, the government earned a grade of C-minus for fiscal year 2000.

Three agencies received A's, which is one more than last year. That is progress. Auditors report that the Department of Energy, the National Aeronautics and Space Administration and the Small Business Administration have effective financial management. This is a notable achievement for the Department of Energy and the Small Business Administration, both of which managed to overcome significant financial management problems reported in the previous years.

In addition, the Office of Personnel Management admirably pulled its grade up from an F last year to a B-minus this year. Despite that progress, the failures of a few agencies continue to tarnish the overall record of the executive branch of the Federal Government. In fact, two agencies regressed. The National Science Foundation fell from an A to a B-plus, and the Department of Transportation fell from a D-plus to a D-minus.

Most disheartening, however, is the abysmal lack of achievement by two significant government departments and one agency. For the 5th consecutive year, the Agency for International Development and two of the government's largest departments, the Department of Defense and the Department of Agriculture, still have major problems. They again received the unacceptable grade of F.

Now we have a new administration, and hopefully it will focus close attention on these continuing failures. If we cannot accurately account for today's expenditures, how can we plan for future surpluses?

We welcome our witnesses today who are most qualified to discuss this important matter: The Honorable David M. Walker, the Comptroller General of the United States; the Honorable Mitchell E. Daniels, Jr., the Bush administration Director of the Office of Management and Budget; and the Honorable Donald V. Hammond,

Acting Undersecretary for Domestic Finance for the Department of Treasury.

Gentleman, we look forward to your testimony, your insights and your recommendations, which will work to end this intolerable situation in the government's financial management.

Again, we must say that this is largely due to the actions of the outgoing President and Cabinet. The new members have reviewed it, and as best they can, they have put various statements forward. Looking at your testimony I was very impressed by it, and yesterday I had an opportunity to mention this situation to the Secretary of the Treasury, and he assured me that next year every single agency will in a timely way get the financial data that are needed. I know he means business.

So, we thank the gentleman from Florida, Mr. Putnam, who is here. Do you have any opening remarks, Mr. Putnam? You are free to voice them.

Mr. PUTNAM. Thank you, Mr. Chairman.

It is always a pleasure to have our Comptroller General here. I am, quite honestly, very amazed he finds time to do his job, as often as he is called up here to testify before committees. It is always a pleasure to have him. His comments are always very important and enlightening.

This is a troubling issue. We have had extensive hearings in the Shays subcommittee on the defense side of the audit reports. Serving on the Agriculture Committee I am also very concerned about the improprieties at the USDA. In fact, just before I came to the committee I was handed a press release from the USDA informing me that they had just given \$1 million to a Kentucky Fried Chicken franchise in my district to preserve two jobs, or some such thing as that. So, it clearly illustrates we have a long way to go.

I look forward to the gentleman's testimony.

Mr. WALKER. That sounds like pretty good pay, Mr. Putnam.

Mr. PUTNAM. It beats being in Congress.

Mr. HORN. Let me swear in all the witnesses. As you know, this is an investigating committee, and we do swear in all the witnesses. Will the Director of the Budget, the Deputy Undersecretary of the Treasury and the Comptroller General please stand and raise your right hands, and those that back you up, I might add.

[Witnesses sworn.]

Mr. HORN. It is a pleasure to have you here, Comptroller General.

STATEMENTS OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE; AND DONALD V. HAMMOND, ACTING UNDERSECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. WALKER. Thank you. Mr. Chairman, Mr. Putnam, it is a pleasure to be here to discuss our report on the U.S. Government's consolidated financial statements for the fiscal year ending September 30, 2000. The report has been provided to you and is being released to the public today.

In summary, this is the fourth consecutive year in which we have been unable to express an opinion on the U.S. Government's con-

solidated financial statements. Certain material weaknesses, internal control, and accounting and reporting issues resulted in conditions that prevented us from being able to provide the Congress, and the American people, an opinion as to whether the government's consolidated financial statements are fairly stated in accordance with U.S. generally accepted accounting principles.

While many of the pervasive and generally long-standing material weaknesses that we have reported in past years remain to be fully resolved, progress continues to be made in addressing the underlying causes of these problems at a number of agencies such as significant financial management system weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation and weak internal controls.

Accelerating the pace of completing ongoing and planned efforts to implement financial management reform is essential, as reports of the various inspectors general and their contract auditors indicate that only 3 of 24 of the CFO Act agencies had neither a material control weakness nor an issue involving compliance with applicable laws and regulations.

Agencies have made marked strides in obtaining unqualified audit opinions in their financial statements. The number of the 24 CFO Act agencies that were able to attain an unqualified opinion on their financial statements from their auditors increased to 18 in fiscal 2000, up from just 6 only 4 years ago. Also, for the first time the Office of Management and Budget [OMB], reported that all 24 CFO Act agencies met their March 1 reporting deadline.

But the timeliness of agencies having audited financial statements must be improved further. Issuing historical financial statements 5 to 6 months after year end is simply too late to be relevant in today's fast-paced, forward-looking and knowledge-based economy. These financial statements and our audit report should be issued much sooner. We should seek to be able to issue these consolidated financial statements and our report months earlier.

For example, the auditors for the Social Security Administration issued their fiscal year 2000 audited financial statements on November 30, 2000, 2 months after the fiscal year end. Other agencies should follow their lead so that we would then be able to issue the consolidated financial statement audit no later than the end of the calendar year.

Many agencies undertake tremendous efforts lasting 5 months or more to produce audited financial statements as of a date and period ending months earlier. The need for such time-consuming procedures often represents nothing less than heroic efforts on behalf of the people who are involved. Both by agency and contractor personnel, these procedures primarily result from inadequate financial management systems and poor controls.

A majority of the unqualified opinions discussed above, meaning the 18, were obtained through expending significant resources, the use of extensive ad hoc procedures and making billions of dollars in adjustments to derive financial statements months after the end of the fiscal year.

In addition, many of the agencies who received qualified opinions, or disclaimers of opinion, also had a number of heroic measures undertaken and spent millions of dollars in order to be able

to get to where they were. It is important to note that the biggest heroic effort is probably related to the consolidated financial statement audit itself; and the dedicated professionals of the Treasury Department, of OMB and GAO who are to be commended for their efforts in trying to make this happen.

However, it is also important to understand that heroic efforts must be combined with sustained efforts to improve agencies' underlying financial management systems and control. If agencies continue, year after year, to rely on significant, costly and time-intensive manual efforts to achieve or maintain unqualified opinions, without making these underlying systemic improvements, it can serve to mislead the public as to the true status of an agency's financial management capabilities. In this case, an unqualified opinion would become an accomplishment without much substance.

Stated differently, we need a substantive victory, not a superficial one. Winning the battle is getting a clean opinion on the financial statements. We must win the war. The war is getting a clean opinion on the financial statements, no material control weaknesses, no compliance problems, and to have systems, controls and procedures such that agencies have timely, accurate and useful information to make informed decisions day to day, not just focusing on today, but also anticipating tomorrow. This is absolutely essential.

The past 4 years have included extensive cooperative efforts and considerable attention by the agency chief financial officers, inspectors general, Treasury, OMB officials and the GAO. From the outset, all parties involved understood the formative challenges that were ahead. As we previously reported, they face the need to overcome decades of neglect in addressing serious financial management and internal control problems across government.

I am pleased to say that in the past few weeks I have met with Secretary of the Treasury, Paul O'Neill, and OMB Director Mitch Daniels to discuss the need for aggressive action to accelerate progress in financial management reform. I am heartened that they strongly support these efforts, and that support is clearly evidenced by their personal statements brought before the committee today.

We have already agreed to cooperatively pursue developing short and long-range strategies and operational plans with key milestones for addressing the problems that have prevented us, the GAO, from expressing an opinion on the U.S. Government's consolidated financial statements. Therefore, at this juncture, with the benefit of several years of experience by the government, and having the required financial statements subject to audit, it is appropriate to focus particular attention on the most serious obstacles to achieving an unqualified opinion on the consolidated financial statements.

These obstacles include, No. 1, financial management problems at specific agencies that have not been able to produce auditable financial statements, especially the Department of Defense and the Department of Agriculture; two, problems in resolving difficulties in reconciling intra-governmental transactions, transactions between government agencies; three, information system security weaknesses that affect agencies across government and not only af-

fect the issue of accountability but also national security and personal privacy; and, four, the need to modernize agency financial management systems to ensure that they routinely provide timely, accurate and useful information for managing operations day to day.

Irrespective of the unqualified opinions on their financial statements, many agencies do not have timely, accurate and useful financial information and sound controls to make informed decisions and to ensure accountability on an ongoing basis. This is what the ultimate goal of financial management reform legislation was when it was enacted in the 1990's.

As we look ahead, it is essential for the government to begin strengthening its financial reporting to make more meaningful information available to the Congress, other policymakers, and the American people. Financial reports must continue to strive to further report our long-range financial commitments and contingencies which will be useful in highlighting the long-range fiscal challenges facing the Nation due to the demographic trends that we face and escalating healthcare costs.

Also, enhanced reporting in certain key areas, including performance information, focusing on results and outcomes that the American people understand and can identify with will be central to managing government operations more efficiently, effectively and economically and in supporting the Government Performance and Results Act.

In addition, enhanced disclosures on the government's most valuable asset, its own employees, or human capital, is needed to draw further attention to the need to revamp Federal strategic human capital management and assess the government's capability to perform its missions in the future.

In closing, Mr. Chairman, I want to underscore the importance of the President and the new administration emphasizing and giving priority to, No. 1, addressing the problems preventing us from being able to express an opinion on the government's consolidated financial statements; No. 2, having effective internal control; and, No. 3, modernizing Federal financial management reporting and related systems as we move forward.

As I stated at the outset of my testimony today, my recent meetings with Treasury Secretary O'Neill and OMB Director Mitch Daniels have been most encouraging. I look forward to working closely and cooperatively with them and the dedicated career staff of GAO, OMB, Treasury and others in order to develop these short and long-range plans and strategies in order to solve the problems and win the war.

Finally, I think it is important to reemphasize the importance of the efforts of this committee in particular, and the Congress in general, to conduct periodic oversight in this area. Having effective financial management and reporting is critical. While the U.S. Government doesn't have to worry about bondholders like the private sector, and State and local governments do, and while the U.S. Government doesn't have a stock price, and therefore there are not market conditions that absolutely mandate that it must have audited financial statements, we must have them in order to maintain the confidence and respect of the American people. We must

also have them in order to make sure that we have the underlying systems, controls, and mechanisms to make sure that we are making informed decisions; and that we are maximizing the economy, efficiency and effectiveness of the Federal Government for the benefit of the American people and assuring accountability over trillions of dollars of resources and assets.

Mr. Chairman, I can assure you that I and the dedicated professionals at GAO stand ready to do our part, and we thank you for your interest and efforts.

Thank you, Mr. Chairman.

Mr. HORN. Well, we thank you, because you have an outstanding staff, and we have worked with it for over 6 years, and you have done a very fine job in trying to pull these parts together.

[The prepared statement of Mr. Walker follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency,
Financial Management, and Intergovernmental Relations,
Committee on Government Reform, House of
Representatives

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U.S. GOVERNMENT
FINANCIAL
STATEMENTS

FY 2000 Reporting
Underscores the Need to
Accelerate Federal
Financial Management
Reform

Statement of David M. Walker
Comptroller General of the United States



G A O

Accountability • Integrity • Reliability

GAO-01-570T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal year 2000. Both the consolidated financial statements and our report are included in the *Fiscal Year 2000 Financial Report of the United States Government* (Financial Report), which was issued today by the Department of the Treasury (Treasury) and is attached to this testimony.

In passing the 1990 Chief Financial Officers (CFO) Act and other financial management reform legislation, such as the Government Management Reform Act and the Federal Financial Management Improvement Act (FFMIA), the Congress sought to overcome the historical lack of timely, accurate, and useful information to assure financial accountability for the federal government. Without timely, accurate, and useful financial information, the government cannot adequately ensure accountability, measure and control costs, manage for results, or make timely and fully informed decisions about allocating limited resources. A critical financial management reform component established by the Congress entails requirements for annual audited financial statements for 24 major federal departments and agencies (CFO Act agencies), beginning with fiscal year 1996, and consolidated financial statements for the U.S. government, beginning with fiscal year 1997.

In summary, this is the fourth consecutive year in which we were unable to express an opinion on the U.S. government's consolidated financial statements. Certain material weaknesses¹ in internal control and accounting and reporting issues resulted in conditions that prevented us from being able to provide the Congress and the American citizens an opinion as to whether the government's consolidated financial statements are fairly stated in accordance with U.S. generally accepted accounting principles. These material weaknesses also affect the reliability of certain information contained in the Management's Discussion and Analysis included in the Financial Report and any other financial management information—including information used to manage the government day to day and budget information reported by agencies—which is taken from the same data sources as the financial statements.

¹ A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or non-compliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

While many of the pervasive and generally long-standing material weaknesses we have reported in past years remain to be fully resolved, progress continues to be made in addressing the underlying causes of these problems—significant financial management systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls. Accelerating the pace of completing ongoing and planned efforts to implement financial management reform is essential, as reports of Inspectors General and their contract auditors indicated that only 3 of the 24 CFO Act agencies had neither a material control weakness nor an issue involving compliance with applicable laws and regulations.

Agencies have made marked strides in obtaining unqualified audit opinions on their annual financial statements. The number of the 24 CFO Act agencies that were able to attain an unqualified audit opinion on their financial statements from their auditors increased to 18 for fiscal year 2000, up from just 6 agencies 4 years ago. Also, for the first time, the Office of Management and Budget (OMB) reported that all 24 CFO Act agencies met the March 1 reporting deadline. But the timeliness of agencies having audited financial statements should be further improved. For example, auditors for the Social Security Administration's (SSA) fiscal year 2000 financial statements issued their report to SSA on November 30, 2000, or 2 months after the close of the government's fiscal year.

Many agencies undertake tremendous efforts, lasting 5 months or more, to produce annual financial statements. The need for such time-consuming procedures, which often represent "heroic efforts" by agency and contractor personnel, primarily result from inadequate financial management systems. A number of the unqualified opinions discussed above were obtained by expending significant resources to use extensive ad hoc procedures and making billions of dollars in adjustments to derive financial statements months after the end of a fiscal year. This approach must be combined with sustained efforts to improve agencies' underlying financial management systems and controls. If agencies continue year after year to rely on significant costly and time-intensive manual efforts to achieve or maintain unqualified opinions without such improvements, it can serve to mislead the public as to the true status of agencies' financial management capabilities. In such a case, an unqualified opinion would become an accomplishment without much substance.

The past 4 years have included extensive cooperative efforts and considerable attention by agency Chief Financial Officers, Inspectors General, Treasury and OMB officials, and the General Accounting Office. From the outset, those involved in these efforts understood that

formidable challenges were ahead. As we have previously reported, they faced the need to overcome decades of neglect in addressing serious financial management and internal control problems across government.

In the past few weeks, I met with Secretary of the Treasury Paul O'Neill and OMB Director Mitch Daniels to discuss the need for aggressive action to accelerate progress in financial management reform. I am heartened that they strongly support these efforts. We have agreed to cooperatively pursue developing short- and long-term strategies and operational plans for addressing the problems that prevent us from expressing an opinion on the U.S. government's consolidated financial statements.

Therefore, at this juncture, with the benefit of several years of experience by the government in having the required financial statements subjected to audit, it is appropriate to focus particular attention on the most serious obstacles to achieving an unqualified opinion on the U.S. government's consolidated financial statements. These obstacles include (1) financial management problems at specific agencies that have not yet been able to produce auditable financial statements, especially the Departments of Defense (DOD) and Agriculture (USDA), (2) problems in resolving difficulties in reconciling intragovernmental transactions, (3) information systems security weaknesses that affect agencies across government, and (4) the need to modernize agency financial management systems to ensure that they routinely provide timely, accurate, and useful information for managing operations day to day.

Irrespective of the unqualified opinions on their financial statements, many agencies do not have timely, accurate, and useful financial information and sound controls with which to make informed decisions and to ensure accountability on an ongoing basis. This is the ultimate goal of financial management reform legislation such as FFMIA, which requires auditors performing financial audits to report whether agencies' financial management systems comply substantially with federal accounting standards, federal financial management systems requirements, and the government's standard general ledger at the transaction level, and is essential to meeting the mandate of the Government Performance and Results Act. For most CFO Act agencies, the auditors reported that agencies' financial management systems did not substantially comply with certain FFMIA requirements.

It is especially important for the Congress and other policymakers to have this kind of financial information in deliberations involving the long-range fiscal policy challenges facing the Congress and our nation. While current budget surpluses offer an opportunity to address today's needs and the

many pent-up demands held in abeyance during years of fighting deficits, they do not eliminate our obligation to prepare for the future. Today's choices must be seen not only in terms of how they respond to today's needs, but also how they affect the future capacity of the nation and its ability to meet the very real and significant fiscal challenges associated with the approaching demographic tidal wave and rising health care costs. The question before this Congress is how to balance today's wants and needs against our nation's long-term challenges.

Such challenges involve reforming and strengthening Medicare and Social Security at the earliest opportunity, as called for by the Trustees of these programs' trust funds in their March 19, 2001, report on the current and projected status of these programs over the next 75 years. The Trustees reported that, while the near-term financial conditions of both Social Security and Medicare have improved since last year's report, the long-term outlook for Medicare's financial future has deteriorated substantially. This has substantial implications for the budget and the economy. This issue must be dealt with from the standpoint of starting to take incremental steps to close the Trustees' projected \$4.6 trillion Hospital Insurance (Medicare Part A) 75-year funding gap, which is only part of an overall Medicare challenge. Also, congressional deliberations on modernizing the Medicare benefits package to include prescription drug coverage must focus attention on incremental solutions, concentrating on targeted and legitimate needs rather than unlimited wants. In addition, any potential benefit expansion should be coupled with program reforms that will assure that we do not make the considerable long-range financial imbalance worse.

The government today is moving from balancing the budget to balancing fiscal risk. Surpluses challenge our nation to move beyond a focus on reducing annual deficits to a broader agenda. They offer us an opportunity to look more closely at what government does and how government does business. That is why it is so essential that efforts continue to build the necessary fundamental foundation through lasting financial management reform. Only by generating timely, accurate, and useful information can the government maximize its economy, efficiency and effectiveness; assure adequate accountability to taxpayers; manage for results; and help decisionmakers make timely and well-informed judgments.

Highlights of Major Issues Relating to the U.S. Government's Consolidated Financial Statements for Fiscal Year 2000

As was the case for fiscal years 1997 through 1999,² our report on the U.S. government's consolidated financial statements for fiscal year 2000 states that certain significant financial systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls continued to hamper the government's ability to accurately report a significant portion of its assets, liabilities, and costs.

Major challenges include the federal government's inability to:

- properly account for and report (1) material amounts of property, equipment, inventories, materials, and supplies, and (2) certain stewardship assets, primarily at DOD;
- properly estimate the cost of certain major federal credit programs and the related loans receivable and loan guarantee liabilities, primarily at USDA;
- estimate and reliably report material amounts of environmental and disposal liabilities and related costs at DOD, and determine the proper amount of various reported liabilities, including postretirement health benefits for military employees and accounts payable and other liabilities for certain agencies;
- accurately report major portions of the net cost of government operations;
- ensure that all disbursements are properly recorded; and
- properly prepare the U.S. government's consolidated financial statements, including balancing the statements, accounting for substantial amounts of transactions between governmental entities, fully ensuring that the information in the consolidated financial statements was consistent with the underlying agency financial statements, and reconciling operating results with budget results.

In addition, we found that (1) the government is unable to determine the full extent of improper payments—estimated to total billions of dollars annually—and therefore cannot develop effective strategies to reduce them, (2) serious, long-standing computer security weaknesses expose the government's financial and other sensitive information to inappropriate disclosure, destruction, modification, and fraud, and critical operations to

²See, for example, *Financial Audit: 1999 Financial Report of the United States Government* (GAO/AMTD-00-101, March 31, 2000).

	<p>disruption, and (3) material control weaknesses affect the government's tax collection activities. Further, the financial management systems of most CFO Act agencies were again reported by their auditors not to be in substantial compliance with certain FFMA requirements.</p> <p>I would now like to discuss in more detail the major issues identified by our work.</p>
Property, Plant, and Equipment and Inventories and Related Property	<p>Because the government lacked complete and reliable information to support these asset holdings, reported at \$484 billion, it could not satisfactorily determine that all assets were included in the financial statements, verify that certain reported assets actually exist, or substantiate the amount at which they were valued. A majority of the property, plant, and equipment and inventories and related property, which is primarily the responsibility of DOD, was not adequately supported by financial and/or logistical records.</p> <p>Without accurate asset information, the government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss, (2) account for acquisitions and disposals of such assets, (3) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, (4) identify and utilize assets when they are needed, and (5) determine the full costs of programs that use these assets.</p> <p>Further, national defense asset unit information reported as Stewardship Information in the Financial Report was incomplete because (1) it did not include billions of dollars of major national defense support real property and equipment, such as missile silos and communications equipment, and (2) amounts were reported in units, rather than in dollars as required by generally accepted accounting principles.</p>
Loans Receivable and Loan Guarantee Liabilities	<p>As of the end of fiscal year 2000, the government reported \$208 billion of loans receivable and \$37 billion of liabilities for estimated losses related to estimated future defaults of guaranteed loans. Certain federal credit agencies responsible for significant portions of the government's lending programs, most notably USDA, were unable to properly estimate the cost of these programs, or estimate the net loan amounts expected to be collected, in accordance with generally accepted accounting principles and budgeting requirements. Unreliable information about the cost of credit programs affects the government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of credit activities.</p>

Liabilities	<p>The government did not maintain adequate systems or have sufficient information necessary to:</p> <ul style="list-style-type: none"> • develop an accurate estimate of key components of DOD's environmental and disposal liabilities, which were reported at \$63 billion, such as liabilities related to unexploded ordnance and residual contaminants from training ranges; • accurately estimate the reported \$192 billion military postretirement health benefits liability included in federal employees and veterans benefits payable because, for example, some of the underlying cost, demographic, and workload data used to develop the estimate were not reliable; • ensure that accurate and complete data were used to estimate a reported \$91 billion of accounts payable and \$175 billion of other liabilities; and • determine whether commitments and contingencies were complete and properly reported. <p>Problems in accounting for liabilities affect the determination of the full cost of the government's current operations and the extent of its liabilities. Also, improperly stated environmental and disposal liabilities and weak internal control supporting the process for their estimation affect the government's ability to determine priorities for cleanup and disposal activities and to allow for appropriate consideration of future budgetary resources needed to carry out these activities.</p>
Cost of Government Operations	<p>The previously discussed material deficiencies in reporting assets and liabilities and the lack of effective disbursement reconciliations and material deficiencies in financial statement preparation, as discussed below, affect reported net costs. Further, the government was unable to support whether the amounts reported in the individual net cost categories on the Statement of Net Cost were properly classified. As a result, the government was unable to support significant portions of the more than \$1.9 trillion reported as the total net cost of government operations, most notably related to DOD's and USDA's net costs. Inaccurate cost information affects the government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required.</p>
Disbursement Activity	<p>Several major agencies did not effectively reconcile disbursements, which is intended to be a key control to detect and correct errors and other misstatements in financial records in a timely manner—similar in concept to individuals reconciling their checkbooks with their bank statements</p>

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each month. Specifically, there were billions of dollars of unreconciled differences between agencies' and Treasury's records of disbursements as of September 30, 2000. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by agencies for inclusion in the President's budget concerning obligations and outlays.

The government did not have adequate systems, controls, and procedures to properly prepare its consolidated financial statements. Such material deficiencies are described below. Also, certain financial information required by generally accepted accounting principles was omitted from the consolidated financial statements. Weaknesses related to the preparation of the consolidated financial statements impair the government's ability to (1) account for billions of dollars of transactions between governmental entities, (2) effectively reconcile operating results reported in the consolidated financial statements with budget results, and (3) fully ensure that the consolidated financial statements were consistent with agency financial statements and were properly balanced.

Intragovernmental Activity and Balances

OMB requires the CFO Act agencies to reconcile selected intragovernmental activity and balances with their "trading partners."³ However, numerous agencies did not fully perform such reconciliations for fiscal year 2000. Using the detail of certain intragovernmental accounts by trading partner that was gathered by the government, we estimated that the amounts reported for agency trading partners for these specific intragovernmental accounts were out-of-balance by more than \$250 billion. In addition, solutions will be required to resolve significant differences reported in other intragovernmental accounts, primarily related to appropriations.

Reconciling Operating Results With Budget Results

The government did not yet have an effective process to obtain information to reconcile fully the reported \$46 billion excess of revenue over net cost and the reported unified budget surplus of \$237 billion. Consequently, it could not identify all items needed to reconcile these amounts.

³Trading partners' are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

Consolidated Financial Statement Compilation

The government could not fully ensure that the information in the consolidated financial statements was consistent with the underlying agency financial statements. These problems are compounded by the need for certain standard general ledger (SGL) accounts to be split between different financial statement line items due to limitations in the government's SGL account structure. In addition, to make the consolidated financial statements balance, Treasury recorded a net \$7 billion item on the Statement of Operations and Changes in Net Position, which it labeled Unreconciled Transactions. An additional net \$0.2 billion of unreconciled transactions was improperly recorded in net cost. Treasury attributes these net out-of-balance amounts primarily to the government's inability to properly identify and eliminate transactions between governmental entities, as discussed above, to agency adjustments that affected net position, and to other errors. However, Treasury was unable to adequately identify and explain the gross components of such amounts. Unreconciled transactions also may exist because the government does not have effective controls over reconciling net position. The net position reported in the consolidated financial statements is derived by subtracting liabilities from assets, rather than through balanced accounting entries. Further, the process for compiling the financial statements involves significant adjustments and reclassifications and requires significant human and financial resources, which lessens the government's ability to perform effective financial analysis of the information.

Ineffective Internal Control

In addition to the material weaknesses noted above, we found that (1) most agencies have not estimated the magnitude of improper payments in their programs and (2) material internal control weaknesses and systems deficiencies continue to affect the government's ability to effectively manage its tax collection activities. We also found that widespread and serious computer control weaknesses, which are further discussed later in this testimony, affect virtually all federal agencies.

Improper Payments

Across government, improper payments occur in a variety of programs and activities, including those related to health care, contract management, federal financial assistance, and tax refunds, and include payments made for unauthorized purposes and for excessive amounts, such as overpayments to program recipients or contractors and vendors. The reasons for improper payments range from program design issues to inadvertent errors to fraud and abuse. While reported estimates of improper payments totaled approximately \$20 billion for both fiscal years

2000 and 1999, the government did not estimate the full extent of improper payments.

As part of its annual financial statements, the Department of Health and Human Services (HHS) has been reporting a national estimate of improper Medicare Fee-for-Service payments since fiscal year 1996. In fiscal year 2000, HHS reported estimated improper Medicare Fee-for-Service payments of \$11.9 billion, or about 7 percent of such benefits—down from \$13.5 billion, or 8 percent, a year earlier and \$23.2 billion, or 14 percent, for fiscal year 1996. HHS' reporting and analysis of improper Medicare payments has helped lead to the implementation of several initiatives to identify and reduce such payments. Annual estimates of improper payments in future audited financial statements will provide information on the progress of these initiatives.

However, most agencies have not estimated the magnitude of improper payments in their programs and comprehensively addressed this issue in their annual performance plans under the Government Performance and Results Act.⁴ For example, the Earned Income Tax Credit (EITC) program—a refundable tax credit available to low-income, working taxpayers—has historically been vulnerable to high rates of invalid claims. During fiscal year 2000, the Internal Revenue Service (IRS) examined about 257,000 suspicious tax returns claiming about \$587 million in EITCs and found that 173,000 of these returns claiming \$395 million in EITCs (67 percent) were invalid. Additionally, during fiscal year 2000, IRS released the results of its study of EITC compliance for tax year 1997. In this study, which is not performed annually, IRS estimated that taxpayers filed returns claiming about \$9.3 billion in invalid EITCs, of which \$1.5 billion (16 percent) either was recovered or was expected to be recovered through compliance efforts. Although the full extent of refunds resulting from invalid EITCs is unknown, the IRS has not routinely estimated the potential magnitude of invalid refunds and has not disclosed an estimate of improper payments in its financial reports.

Without a systematic measurement of the extent of improper payments, agency management cannot determine (1) if the problem is significant enough to require corrective action, (2) how much to invest in preventative internal control, (3) the success of efforts implemented to reduce improper payments, or (4) the magnitude or trends of improper

⁴Financial Management: Billions in Improper Payments Continue to Require Attention (GAO-01-44, October 27, 2000).

	payments, which limits the ability to pinpoint or target mitigation strategies.
Tax Collection Activities	<p>Material internal control weaknesses and systems deficiencies continue to affect the government's ability to effectively manage its tax collection activities.⁵ This situation results in the need for extensive, costly, and time-consuming ad hoc programming and analyses, as well as material audit adjustments, to prepare basic financial information. As further discussed later in this testimony, this approach cannot be used to prepare such information on a timely, routine basis to assist in ongoing decision-making. Additionally, the severity of the system deficiencies that give rise to the need to resort to such procedures for financial reporting purposes, as well as deficient physical safeguards, result in burden on taxpayers and lost revenue.</p> <p>The lack of appropriate subsidiary systems to track the status of taxpayer accounts affects the government's ability to make informed decisions about collection efforts. Due to errors and delays in recording activity in taxpayer accounts, (1) taxpayers were not always being credited for payments made on their tax liabilities and (2) the government lost opportunities to retain or offset overpayments made by a taxpayer for one period to collect on outstanding amounts owed for another period. In addition, the government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government. This could result in billions of dollars not being collected and adversely affect future compliance.</p> <p>The federal government also continues to be vulnerable to loss of tax revenue due to weaknesses in preventive and detective controls over disbursements for tax refunds. Although the government does have detective controls in place, they are not applied to millions of tax returns estimated to have billions of dollars in underreported tax liabilities. These conditions expose the government to potentially billions of dollars in losses due to inappropriate refund disbursements.</p> <p>Additionally, the government does not perform sufficient up-front verification procedures to ensure the validity of amounts claimed by taxpayers as overpayments prior to making disbursements for refunds. Finally, continued weaknesses in physical controls over cash, checks, and sensitive data received from taxpayers increase both the government's and</p>

⁵ *Financial Audit: IRS' Fiscal Year 2000 Financial Statements* (GAO-01-394, March 1, 2001).

	<p>the taxpayers' exposure to losses and increases the risk of taxpayers becoming victims of crimes committed through identity fraud.</p> <p>IRS senior management continues to be committed to addressing many of these operational and financial management issues and has made a number of improvements to address some of these weaknesses. Successful implementation of long-term efforts to resolve these serious problems will require the continued commitment of IRS management as well as substantial resources and expertise.</p>
Compliance With Applicable Laws and Regulations and FFMIA Requirements	<p>Our work to determine compliance with selected provisions of laws and regulations related to financial reporting was limited by the material weaknesses discussed above. Instances of noncompliance, some of which the auditors reported were material to individual agency financial statements, are included in individual agency audit reports. However, none of these instances were material to the consolidated financial statements. Additionally, as further discussed later in this testimony, for most CFO Act agencies, the auditors reported that agencies' financial management systems did not substantially comply with certain FFMIA requirements.</p>
Need to Accelerate Financial Management Reform Efforts	<p>Across government, we are seeing financial management improvement initiatives that could ultimately lead to an unqualified opinion on the U.S. government's consolidated financial statements. However, accelerating the pace of completing ongoing and planned efforts to implement financial management reform is essential, as reports of Inspectors General and their contract auditors indicated that only 3 of the 24 CFO Act agencies had neither a material control weakness nor an issue involving compliance with applicable laws and regulations. While many of the pervasive and generally long-standing material weaknesses we have reported for the past 3 years remain to be fully resolved, some progress continues to be made in addressing the underlying causes of these problems—significant financial systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls.</p> <p>The number of the 24 CFO Act agencies that were able to attain an unqualified audit opinion on their financial statements has increased. For fiscal year 2000, 18 of the 24 CFO Act agencies received unqualified opinions from their auditors, up from 6 agencies four years ago. Also, OMB has reported that, for the first time, all 24 CFO Act agencies met the March 1 reporting deadline. While the timeliness of agencies' financial statement submissions has improved, agencies' must work toward having their</p>

financial statements prepared and audited much closer to the end of a fiscal year, as March 1 is a reporting deadline rather than a benchmark indicating timely financial reporting. For example, auditors for SSA were able to report on SSA's fiscal year 2000 financial statements on November 30, 2000, or 2 months after the close of the government's fiscal year.

While agencies are making some progress in obtaining unqualified audit opinions on annual financial statements, many of these opinions were obtained by expending significant resources to use extensive ad hoc procedures and making billions of dollars in adjustments to derive financial statements months after the end of a fiscal year. The need for such time-consuming procedures, which often represent "heroic efforts," primarily result from inadequate financial management systems. Also, irrespective of the unqualified opinions on their financial statements, many agencies do not have timely, accurate, and useful financial information and sound controls with which to make informed decisions and to ensure accountability on an ongoing basis.

For example, IRS' unqualified opinion on its overall financial statements for the first time in fiscal year 2000 was the culmination of several years of extraordinary effort on the part of IRS senior management and staff to develop compensating processes to work around its serious systems and control weaknesses to derive year-end balances for its financial statements. While IRS' efforts did address several management issues we raised in previous audits, its approach to obtaining the unqualified opinion relied heavily on costly, time-consuming processes; statistical projections; external contractors; substantial adjustments; and monumental human efforts that extended well after the fiscal year-end. This was particularly the case with respect to reporting amounts for both taxes receivable and property and equipment. Because IRS' systems cannot accurately track amounts representing taxes receivable, IRS has for the past 4 years employed a complex statistical sampling process to derive the balance reported on its financial statements; this process takes months to complete, requires extensive human and financial resources, and results in tens of billions of dollars in adjustments annually to present a balance that is good for one day only. Additionally, because IRS does not have an adequate property management system, it had to use contractors to (1) perform statistical sampling procedures to derive a reliable balance for property and equipment in fiscal year 1999 and (2) analyze fiscal year 2000 transactions to derive the September 30, 2000, balance for property and equipment, a process that extended into February 2001.

Another case involves the Department of Justice (DOJ). For fiscal year 1999, auditors expressed a qualified opinion on DOJ's financial statements. DOJ's Office of Inspector General (OIG) reported this year that removal of the qualification on DOJ's balance sheet required tremendous efforts and cost. According to the OIG, because DOJ lacks automated systems to readily support ongoing accounting operations, financial statement preparation, and the audit process, many tasks had to be performed manually. For example, in order to determine deferred revenue at year end, the Immigration and Naturalization Service manually counted approximately 2 million applications, which the OIG said involved substantial preparation and several preliminary counts throughout the fiscal year and caused delays in the processing of applications. The OIG said also that DOJ incurred substantial costs and depended heavily on contractors to assist in the cleanup of accounting transaction backlogs and to provide other accounting support.

In addition, the Department of Transportation's (DOT) Federal Aviation Administration (FAA) used alternative procedures and labor-intensive methods to prepare its fiscal year 1999 financial statements, which received an unqualified audit opinion from the DOT Inspector General. The need for these efforts stemmed primarily from FAA's long-standing weaknesses in accounting for property caused by the lack of an integrated property system. The DOT Inspector General also reported that, if improvements to address this issue were not made, the Department would have to continue the same type of extraordinary, expensive, and labor-intensive efforts in the future and that such efforts are not sustainable for the long term.

In fiscal year 2000, when FAA converted its real property system to a new property system, the number of real property items unexpectedly increased from about 14,000 to about 18,000 as of September 30, 1999 and 2000, respectively. In addition, FAA inappropriately changed property acquisition dates in its database, which caused depreciation expense for fiscal year 2000 and the net value of property as of September 30, 2000, to be incorrectly reported. For example, of the 216 FAA property items, having a total value of \$398 million, that were tested as part of the DOT Inspector General's fiscal year 2000 DOT financial statement audit, 58 items (27 percent) were found to have incorrect acquisition dates, causing the net value of these tested items to be overstated by \$78 million. Because the Inspector General could not substantiate FAA's property account balances, both FAA and DOT received a qualified opinion on their fiscal year 2000 financial statements. We initially designated FAA's financial

management as a high-risk area in 1999 and continued that designation in 2001.⁶

Situations such as these demonstrate the tremendous efforts, lasting 5 months or more, many agencies use to produce annual financial statements. These agencies undertake far more work to prepare financial statements, beginning at the close of a fiscal year, than would be necessary if they had basic financial systems in place to routinely provide the data. Information to compile agency financial statements should flow from their financial management systems. Agencies will continue to rely on significant costly and time-intensive manual efforts to achieve or maintain unqualified opinions until automated, integrated processes and systems are implemented that readily produce the necessary information. The need for agencies to improve financial management systems is further discussed later in this testimony.

These efforts prevent financial management staff from doing other financial-related work such as financial analyses, which could directly support strategic decision-making and ultimately improve overall business performance. In our *Executive Guide: Creating Value Through World-class Financial Management* (GAO/AIMD-00-134, April 2000), we identified the success factors, practices, and outcomes associated with world-class financial management efforts. We found that many leading finance organizations have a goal to reduce the time spent on routine accounting activities, such as financial statement preparation, so that financial management staff can spend more time on activities such as business performance analysis or cost analysis.

Major Obstacles to Unqualified Opinion on Consolidated Financial Statements

As I mentioned earlier, the federal government has been required to prepare and have audited consolidated financial statements for the past 4 years. Successfully meeting this requirement is tightly linked to the requirement for the 24 CFO Act agencies to also produce auditable financial statements. This has stimulated extensive cooperative efforts and considerable attention by agency Chief Financial Officers, Inspectors General, Department of the Treasury and OMB officials, and the General Accounting Office. Those involved in these efforts understood that formidable challenges were ahead, as we had previously reported the need to overcome decades of neglect in addressing serious financial management and internal control problems across government. With the benefit of several years' experience by the government in having the

⁶See, for example, *High-Risk Series: An Update* (GAO-01-263, January 2001).

required financial statements subjected to audit, the time has come to focus even more intensified attention on the most serious obstacles to achieving an unqualified opinion on the U.S. government's consolidated financial statements.

Reforming Financial
Management at the
Department of Defense
(DOD)

The largest impediment to an opinion on the U.S. government's consolidated financial statements is DOD's serious financial management problems, which we have designated as high risk since 1995.⁷ To date, none of the military services, or the Department as a whole, have passed the test of an independent financial audit because of pervasive weaknesses in DOD's financial management systems, operations, and internal control, including an inability to compile financial statements that comply with generally accepted accounting principles. The Department has made progress in a number of areas, but is far from solving a range of serious financial management problems. Their resolution, however, is key to having auditable consolidated financial statements because DOD has annual budget authority of about \$310 billion, or about 16 percent of the entire federal budget, and is accountable for vast government assets worldwide.

Despite progress, ineffective asset accountability and lack of effective internal controls continue to adversely affect visibility over DOD's estimated \$1 trillion investment in weapon systems and inventories. These weaknesses can affect the Department's ability to ensure that materials are on hand when needed and prevent the purchase of assets already on hand. Further, unreliable cost and budget information related to a reported nearly \$1 trillion of liabilities and about \$347 billion⁸ of net costs negatively affects DOD's ability to effectively measure performance, reduce costs, and maintain adequate fund control. In addition, we are concerned that many of the planned financial management improvement initiatives are designed to result in a one-time, year-end number for financial statement purposes. As such, they will not result in the production of timely and reliable financial and performance information for ongoing use by management.

⁷See, for example, GAO-01-263, January 2001.

⁸This amount was reported on the Department's fiscal year 2000 financial report, whereas the \$310 billion discussed in the preceding paragraph represents an estimate of the amount of budget authority shown in the documents accompanying the President's budget submission. Differences between these amounts are the result of (1) timing differences in the receipt of budgetary resources and recording associated expenses and (2) unknown errors in the amounts shown in the financial statements, which were unauditable.

A visible, substantive, and sustained commitment from the Secretary of Defense and the Deputy Secretary of Defense, as well as from the military and civilian leadership, will be needed to overhaul DOD's financial operations. Personnel throughout the Department must share a common goal of establishing modern and integrated financial management systems, processes, and controls that not only produce financial statements that can withstand the test of an audit, but more importantly routinely generate timely, reliable, and useful financial information for day-to-day management and operations purposes. The Secretary of Defense has indicated that he intends to include financial management reform among his top priorities. The Secretary of Defense's personal commitment and involvement will be critical to the success of efforts to overhaul DOD's financial management.

As we testified before you in May 2000⁹ and the House Task Force on Defense and International Relations in July 2000,¹⁰ both short- and long-term actions will be needed to improve the Department's financial management operations. In the short term, it will be essential to continue efforts to standardize, streamline, and simplify processes; to strengthen and enforce existing controls; to ensure basic transaction processing, which today is a major impediment, as well as a cost that can be greatly reduced; to develop more reliable estimates of future liabilities; to enhance human capital; and to oversee performance. At the heart of the Department's long-term financial management challenge is hundreds of outdated and free-standing information systems. These systems are not integrated and have a range of individual weaknesses, some very serious, and collectively simply do not get the job done.

Thus, the ultimate resolution of DOD's financial management problems—which are pervasive, deeply rooted, and complex in nature—must be closely tied to addressing its interrelated problems in the logistics, contract management, acquisition, strategic planning, support infrastructure, human capital, and information technology areas, including information security. As detailed in a January 2001 report on DOD's performance and accountability,¹¹ we have identified DOD financial management and these additional interrelated areas as the Department's

⁹ *Department of Defense: Progress in Financial Management Reform* (GAO/T-AIMD/NSIAD-00-163, May 9, 2000).

¹⁰ *Department of Defense: Implications of Financial Management Issues* (GAO/T-AIMD/NSIAD-00-264, July 20, 2000).

¹¹ *Major Management Challenges and Program Risks: Department of Defense* (GAO-01-244, January 2001).

greatest challenges to developing world-class operations and activities to support its forces. To its credit, the Department has initiated a number of department-wide reform initiatives and other actions to improve its key business processes, not only in the financial area, but also in such areas as information management, weapon system acquisitions, and logistics reengineering. These initiatives have produced some positive results, but four key underlying causes of these problems within DOD have not yet been effectively addressed: (1) a lack of top-level management attention to and accountability for correcting problems, (2) cultural resistance to change, including service parochialism and stovepiped operations, (3) a lack of results-oriented goals and performance measures and monitoring, and (4) inadequate incentives for seeking change.

In this regard, DOD's experience in addressing the Year 2000 (Y2K) computing challenge can serve as a guidepost to overhaul the Department's financial management systems.

- First, DOD recognized that Y2K was a Chief Executive Officer issue, not just a Chief Information Officer issue. The Deputy Secretary took direct control and exerted strong overall leadership. DOD's financial management challenges cut across its operations, similar to Y2K. Given DOD's corporate culture, strong, direct, and sustained financial management reform leadership must come from the top.
- Second, Y2K had a date certain. But it also had a series of milestone dates, together with periodic self-reporting to gauge progress, to enable mid-course corrections, and to hold people accountable. To overhaul DOD's financial management system, a clear plan with an end date and enforced interim milestones will be essential.
- Third, for Y2K, DOD followed a standard, disciplined approach. Given the complexity of DOD's financial management improvement challenge, it will be particularly important that DOD fully adhere to the information technology investment controls of the Clinger-Cohen Act.
- Finally, for Y2K, DOD had extensive validation and verification by the Inspector General, as well as end-to-end testing. Meaningful testing and reporting by DOD must be critical components of a successful financial management system overhaul at DOD.

Focusing on Intragovernmental Transactions

As discussed earlier in this testimony, another major impediment that must be overcome is the government's inability to properly account for billions of dollars of transactions between federal government entities; that is, intragovernmental transactions. Agencies' accounts can be out of

balance with each other, for example, when one or the other of the affected agencies does not properly record a transaction with another agency or the agencies record the transactions in different accounting periods. These out-of-balance conditions can be detected and corrected by instituting procedures for reconciling transactions between agencies on a regular basis and in a timely manner.

To help address this problem, for fiscal year 2000, OMB required CFO Act agencies to reconcile selected intragovernmental activity and balances with their trading partners. With full and proper implementation, the trading partner concept can begin to provide the government critical information with which to analyze the nature of intragovernmental account differences and develop effective solutions. However, numerous agencies did not complete reconciliations of intragovernmental activity and balances with their trading partners for fiscal year 2000. Using the detail of certain intragovernmental accounts by trading partner that was gathered by the government, we estimated that the amounts reported for agency trading partners for these specific intragovernmental accounts were out-of-balance by more than \$250 billion.

The control weaknesses relating to unreconciled intragovernmental transactions, combined with the significant volume of transactions and number of reporting entities, can result in misstatements in the financial statements, hinder the ability of the government to identify misstatements that may exist, and may contribute to the amount of reported unreconciled transactions. The Joint Financial Management Improvement Program has initiated a study to further focus on identifying the causes of and solutions to the government's intragovernmental transaction problem.

Resolving Financial Management Issues at the Department of Agriculture (USDA)

USDA is another major agency that continues to face challenges in correcting severe and long-standing financial management problems and achieving financial accountability over the billions of dollars of assets required to carry out its diverse missions.¹² Since 1991, USDA's Office of Inspector General has issued a series of unfavorable financial audit reports on USDA's consolidated financial statements.

USDA Inspector General financial statement audits have, for example, determined that USDA continues to be unable to provide documentation to support numerous material financial statement line items. Also, the

¹² *Major Management Challenges and Program Risks: Department of Agriculture* (GAO-01-242, January 2001).

Inspector General has identified persistent internal control weaknesses over USDA's financial management systems, food stamp receipt claims, and security controls for information technology.

In addition, since fiscal year 1994, the Inspector General has reported material weaknesses in the processes and procedures used by USDA's lending agencies to estimate and reestimate loan subsidy costs for the Department's net credit program receivables, which totaled a reported \$73.8 billion as of September 30, 2000. As a result, USDA has been unable to implement the Federal Credit Reform Act of 1990 and related accounting standards. In addition, these problems materially affect USDA's budget submissions because the same cost estimates are generally used for both budget preparation and financial reporting. Because the Inspector General can not provide assurance on USDA's credit reform financial data, the Congress does not know whether the costs of USDA's loan programs, estimated in excess of \$24.1 billion, as of September 30, 2000, can be relied upon to base its decisions about whether to expand or scale back the agency's loan programs.

Further, the Inspector General identified internal control and accounting problems involving \$5.4 billion in general property, plant, and equipment reported by USDA in its fiscal year 2000 consolidated financial statements. For instance, the Inspector General reported material internal control weaknesses relating to personal property valued at a reported \$597 million. Also, the Inspector General could not substantiate over \$5.3 billion of real property reported by USDA on its fiscal year 2000 consolidated financial statements, most of which relates to assets that are the responsibility of the Forest Service.

The inability to substantiate USDA's real property, and thus contributing to the Inspector General's disclaimer of opinion, occurred because the Forest Service was unable to produce auditable fiscal year 2000 financial statements within established timeframes.¹³ Since 1999, we have designated the Forest Service financial management as a high-risk area due to its serious financial management systems weaknesses and the major hurdles it faces in achieving financial accountability.¹⁴

¹³The Commodity Credit Corporation, an agency component of USDA, was also unable to provide the Inspector General with auditable financial statements within established timeframes and also contributed to the Inspector General's disclaimer of opinion on the USDA's consolidated financial statements.

¹⁴See, for example, GAO-01-263, January 2001.

USDA has completed several actions and begun others that, if successfully implemented, represent important steps toward first achieving an unqualified opinion on its financial statements and ultimately obtaining overall financial accountability. With the commitment of the Secretary and senior management across the Department, attaining an unqualified opinion on USDA's financial statements is achievable if USDA successfully implements an integrated financial management system; fundamentally improves its underlying internal controls, financial management systems, and operations to provide the capability for routine production of timely, accurate, and useful data; and continues to have additional resources devoted to addressing its financial management deficiencies.

Addressing Computer Security Weaknesses

Evaluations of computer security continue to show that federal computer security is fraught with serious and widespread weaknesses.¹⁵ As a result, federal assets continue to be at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Significant computer security weaknesses in systems that handle the government's unclassified information continue to be reported in each of the major federal agencies.

The computer security weaknesses covered the full range of computer security controls. For example, physical and logical access controls were not effective in preventing and detecting system intrusions and misuse. In addition, software change controls were ineffective in ensuring that only properly authorized and tested software programs were implemented. Further, duties were not adequately segregated to reduce the risk that one individual could execute unauthorized transactions or software changes without detection. Finally, sensitive operating system software was not adequately controlled, and adequate steps had not been taken to ensure continuity of operations. The risks associated with these weaknesses are heightened because of the increasing interconnectivity of today's computerized systems and use of the Internet that further exposes them to outside hackers.

The government is not in a position to estimate the full magnitude of actual damage and loss resulting from federal computer security weaknesses because it is likely that many such incidents are either not

¹⁵ *Information Security: Serious and Widespread Weaknesses Persist at Federal Agencies* (GAO/AIMD-00-286, September 6, 2000).

detected or not reported. However, GAO and IG reports on agency computer security weaknesses highlight the potential for negative impacts.

For example, computer control weaknesses at DOD increased the vulnerability of its interconnected systems to unauthorized access to modify, steal, and destroy DOD data, including financial, procurement, and logistics data. Also, weaknesses identified at HHS's Health Care Financing Administration, IRS, and the Department of Veterans Affairs place medical, tax, and other sensitive records at risk of unauthorized disclosure, modification, and destruction. Unauthorized disclosure of sensitive information has led to instances of identity theft, in which individuals use such information to commit financial crimes, such as fraudulently establishing credit and running up debts. In addition, pervasive computer security weaknesses at the Department of the Treasury placed billions of dollars of payments and collections at significant risk of loss or fraud in its role as the government's central financial manager, disbursing, and collection agency. Further, the vulnerability of mission-related systems, such as those at the Environmental Protection Agency and the Department of Energy, to tampering, disruption, and misuse increase the vulnerability of the agencies' financial systems.

We and the Inspectors General have issued numerous reports that identify computer security weaknesses in the federal government and have made scores of recommendations to agencies regarding specific steps they should take to make their security programs more effective. Also, in 2001, we again reported information security as a high-risk area across government, as we did in our 1997 and 1999 high-risk series.¹⁶

As we have reported in the past, information security problems continue to persist, in large part, because agency managers have not yet established comprehensive security management programs. An effective program would include guidance and procedures for assessing risks, establishing appropriate policies and related controls, raising awareness of prevailing risks and mitigating controls, and evaluating the effectiveness of established controls. While some agencies have taken steps to develop and implement security policies and have established security awareness programs, the other key elements of an effective security management program have not been implemented. The implementation of a comprehensive security management program at all agencies would

¹⁶See, for example, GAO-01-263, January 2001.

provide the government with a framework for resolving computer security problems and managing computer security risks on an ongoing basis.

The Congress has expressed concern about the serious and pervasive nature of computer security weaknesses and the resulting risks to federal government systems. Most recently, government information security reform provisions in the fiscal year 2001 National Defense Authorization Act are intended to strengthen information security practices throughout the government. Specifically, this new legislation requires annual agency and Inspectors General evaluations of agency security programs. Further, it requires each agency to develop and implement an agencywide information security program to provide information security for all operations and assets of the agency.

In addition, other efforts have been initiated at the governmentwide level to improve information security. For example, the federal Chief Information Officers Council has taken steps to raise awareness, promote best practices, and provide agencies tools for improving their security program. During 2000, the Council sponsored development of a self-assessment guide for agencies to serve as a means of measuring progress in improving information security. Also, the Federal Computer Incident Response Capability (FedCIRC) at the General Services Administration and the National Infrastructure Protection Center located in the Federal Bureau of Investigation have both expanded their efforts to issue warnings of potential computer intrusions or misuse and to assist in responding to computer security incidents. It is important to maintain the momentum of these governmentwide efforts and ensure that the activities currently under way are coordinated under a comprehensive strategy and that the roles and responsibilities of the numerous organizations with central responsibilities are clearly defined.

Improving Financial Management Systems

As I stated earlier, and it bears repeating because it represents the ultimate goal of the CFO Act, a central challenge is the need for agencies to generate timely, accurate, and useful data throughout the year by overhauling financial and related management information systems. The CFO Act calls for the modernization of financial management systems, including the systematic measurement of performance, the development of cost information, and the integration of systems—program, budget, and financial.

To help stimulate attention to this challenge, the Congress passed the Federal Financial Management Improvement Act (FFMIA) of 1996, which requires auditors performing financial audits to report whether agencies'

financial management systems comply substantially with federal accounting standards, federal financial management systems requirements, and the government's standard general ledger at the transaction level. For fiscal year 2000, reports of Inspectors General and their contract auditors indicated that only 5 of the 24 CFO Act agencies' financial management systems were in substantial compliance with the three federal financial management systems requirements of FFMLA.

Noncompliance with FFMLA, which we further discuss in our report, *Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1999* (GAO/AIMD-00-307, September 29, 2000), is indicative of the overall continuing poor condition of many financial systems across government. We reported that the reasons for systems' noncompliance included nonintegrated systems, inadequate reconciliation procedures, noncompliance with the government's standard general ledger, lack of adherence to accounting standards, and weak security over information systems. We have also reported that agency remediation plans, required by FFMLA, may not adequately address the system deficiencies. As required by FFMLA, GAO will report to the Congress by October 1, 2001, on agencies' FFMLA implementation for fiscal year 2000.

Bringing financial management systems into compliance with the requirements of FFMLA is a complex and difficult challenge. Through the rigors of the financial statement audit process and the requirements of FFMLA, agencies have gained a better understanding of their financial management weaknesses and the impetus to resolve problems caused by those weaknesses. At the same time, agencies are slowly making progress in addressing their problems.

Facing the Year 2000 (Y2K) challenge of ensuring that systems functioned properly at the turn of the century understandably took priority for federal agencies and resulted in some agencies delaying financial systems changes. Now that the federal government has made the successful conversion to Year 2000, it can apply those valuable lessons to financial systems modernization. As I mentioned earlier, among the lessons learned were the importance of (1) providing high-level congressional and executive branch leadership, (2) understanding the importance of computer-supported operations, (3) providing standard guidance, (4) establishing partnerships, (5) facilitating progress and monitoring performance, and (6) implementing fundamental information technology improvements and disciplined processes.

Significant time and wise investments are needed for agencies to address and correct long-standing financial management systems problems. Over

the longer term, agencies must address their serious systems problems by applying the framework outlined in the Clinger-Cohen Act and implementing guidance. This includes (1) adopting sound information technology investment and control processes, (2) designing well-developed architectures to guide information flows for financial and other related management information, and (3) establishing disciplined approaches for developing and acquiring computer software. Strong partnerships between Chief Financial Officers, Chief Information Officers, and program managers are essential to achieve these goals.

Ultimately, to fully meet the goals of financial management reform legislation, agencies will need to be able to generate timely, accurate, and useful financial and management information, including reporting performance results, to make decisions and monitor government performance every day. Agencies will also need to have effective internal control in place and must ensure compliance with applicable laws and regulations.

Moving From Balancing the Budget to Balancing Fiscal Risk

Meeting legislative financial management reforms and modernizing financial management systems will be especially important to provide the Congress and other policymakers timely, accurate, and useful information in deliberations involving the long-range fiscal policy challenges facing our nation. As I recently testified before the Senate Committee on the Budget, the government today is moving from balancing the budget to balancing fiscal risk.¹⁷

This Congress and the President face a very different set of budget choices than did their predecessors. For over 15 years, fiscal policy has been seen in the context of the need to reduce the deficit. The policies and procedures put in place to achieve a balanced budget do not provide guidance for fiscal policy in a time of surplus.

While considerable uncertainty surrounds both short- and long-term budget projections, we know two things for certain: the population is aging and the baby boom generation is approaching retirement age. Although the 10-year horizon looks better in the Congressional Budget Office's (CBO) January 31, 2001, projections than it did in July 2000, the long-term fiscal outlook looks worse. In the longer term—beyond the 10-year budget window of CBO's projections—the share of the population

¹⁷ *Long-term Budget Issues: Moving From Balancing the Budget to Balancing Fiscal Risk* (GAO-01-285T, February 6, 2001).

over 65 will begin to climb, and the federal budget will increasingly be driven by demographic trends and rising health care costs.

In this regard, I have consistently stressed that without meaningful reform, demographic and cost trends will drive Medicare spending to unsustainable levels but that today's projected surpluses provide an opportunity to act before these trends make needed changes more painful and disruptive. On March 19, 2001, the Trustees of the Social Security and Medicare trust funds reported on the current and projected status of these programs over the next 75 years. The near-term financial conditions of both Social Security and Medicare have improved since last year's report. This should not distract from focusing on the more important long-term perspective. The Medicare Trustees' latest projections incorporate more realistic assumptions about long-term health care spending and, as a result, the long-term outlook for Medicare's financial future has deteriorated substantially since the last Trustees' Annual Report.

Last week, I testified before the Senate Committee on Finance that we must capitalize on momentum gathering in the Congress and elsewhere to take action to adopt effective cost containment reforms alongside potential benefit expansions.¹⁸ The new consensus that Medicare is likely to cost more than previously estimated serves to reinforce the need to take prompt action. This issue, in part, must be dealt with from the standpoint of starting to take incremental steps to close the Trustees' projected \$4.6 trillion Hospital Insurance (Medicare Part A) 75-year funding gap. Also, it is important that any benefit expansion efforts be coupled with adequate program reforms so as not to worsen Medicare's long-range financial condition. Congressional deliberations on modernizing the Medicare benefits package to include prescription drug coverage must focus attention on incremental solutions, concentrating on meeting targeted and legitimate needs rather than on unlimited wants.

While current budget surpluses offer an opportunity to address today's needs and the many pent-up demands held in abeyance during years of fighting deficits, they do not eliminate our obligation to prepare for the future. Today's choices must be seen not only in terms of how they respond to today's needs, but also how they affect the future capacity of the nation and its ability to meet the very real and significant fiscal challenges associated with the approaching demographic tidal wave. Without a change in entitlement programs, demographics will overwhelm

¹⁸ *Medicare: Higher Expected Spending and Call for New Benefit Underscore Need for Meaningful Reform* (GAO-01-538T, March 22, 2001).

the surplus and drive us back into escalating deficits and debt. In this regard, for entitlement programs, the key question is not trust fund solvency but overall program sustainability.

The question before this Congress is how to balance today's wants and needs against our nation's long-term challenges. Surpluses challenge our nation to move beyond a focus on reducing annual deficits to a broader agenda. They offer us an opportunity to look more closely at what government does and how government does business. The budget surpluses before us offer policymakers the opportunity to strike a balance between addressing today's needs and the obligation to hand a strong economy and sustainable fiscal policies on to our children, our grandchildren, and future generations.

As we look ahead, it will be essential for the government to begin strengthening its financial reporting to make more meaningful information available to the Congress, other policymakers, and the American public. Financial reports must continue to strive to further report on long-range financial commitments and contingencies, which will be useful in highlighting the long-range fiscal policy challenges facing the nation. Also, enhanced reporting in certain key areas, including performance information (i.e., results and outcomes), will be central to managing government operations more efficiently, effectively, and economically and in supporting the Government Performance and Results Act. In addition, enhanced disclosures on the government's most valuable assets, its own employees—or human capital, is needed to draw further attention to the need to revamp federal strategic human capital management and assess the government's capability to perform its missions in the future.

In closing Mr. Chairman, I want to underscore the importance of the President and the new Administration emphasizing and giving priority to (1) addressing the problems preventing us from being able to express an opinion on the government's consolidated financial statements, (2) having effective internal control, and (3) modernizing financial management systems. As I stated at the outset of my testimony today, my recent meetings with the Treasury Secretary and the OMB Director have been most encouraging. I look forward to working closely and cooperatively with them in developing the short- and long-term strategies and plans necessary to address the problems I have discussed this morning.

Finally, I want to reiterate the value of sustained congressional interest in these issues, as demonstrated by this hearing and those held to oversee financial management reform at particular agencies. Your work and that of

the committee over the past years to facilitate government management reform have been a catalyst to the progress we have seen to date and will be critical to ultimately restoring the confidence of citizens in the federal government as a financial steward that is accountable for its finances. It will be key that the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving these previously intractable problems and support improvement efforts.

I thank you for the opportunity to testify before you today, and I would be pleased to answer questions you or the members of the Subcommittee may have at this time.

GAO Contacts

For future contacts regarding this testimony, please call Jeffrey C. Steinhoff, Managing Director, or Gary T. Engel, Director, Financial Management and Assurance, on (202) 512-2600.

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Mr. HORN. We will have the testimony of Mr. Hammond before we go to questions on panel one.

So, Mr. Hammond, Undersecretary for Domestic Finance, Department of the Treasury, and a frequent witness here, we are glad to see you back, although as I passed the Treasury yesterday it looks like some of the place is still burned. When are we going to solve that problem? The Treasury Department is the second oldest building in Washington.

Mr. HAMMOND. And, as you can expect with the second oldest building in Washington, it is going through some major renovations; they keep finding more interesting things as they knock down a wall here and move a partition there. It is going to be in really great shape when it is all done, but, I am afraid it is about a 5-year process going forward.

Mr. HORN. Well, we are glad to hear your testimony. You have a major role in this. I agree with the Comptroller General. As I mentioned to you, the Secretary of the Treasury and I chatted about this yesterday, and he means business on people meeting those deadlines next year.

Mr. HAMMOND. Thank you, Mr. Chairman. I am very pleased to appear today again to discuss the financial report of the U.S. Government, and I would like to thank you for your focus and continuing support of improving Federal Government financial accountability and reporting.

I ask that my written statement be included in the record in its entirety.

The Department of the Treasury is dedicated to producing useful governmentwide financial statements and has devoted considerable resources to this effort. Further evidencing this commitment, as you mentioned, Secretary O'Neill has submitted a written statement for the record for this hearing as well evidencing his strong support.

Mr. HORN. Without objection, that will be put in the record at this point.

Mr. HAMMOND. Thank you.

While we are pleased again to issue the fiscal year 2000 financial report on time this year, actually we are a day early, reporting not fully reliable financial results 6 months after the close of a fiscal year is simply not good enough. Working with the Federal community, we have made incremental progress each year, but incremental progress may not prove to be sufficient.

Treasury, in conjunction with OMB and the GAO, will conduct a comprehensive review of the financial statement production process. While we have made significant progress in performing the consolidation, the remaining challenges warrant a fresh look.

Additionally, later this year Treasury will implement the first phase of our multiyear revamping of governmentwide central accounting systems and processes for reporting budget execution information. This is a critical first step toward improving overall Federal financial management.

Within Treasury, the Financial Management Service is primarily responsible for producing these statements; and on a personal note I would very much like to thank all the people at Treasury and

FMS who have really worked tirelessly to produce this year's report and the improvements that we are talking about.

This past year we continued to focus on three critically important areas: first, ensuring that the financial information reported to us by the program agencies is consistent with the information in the agency's own financial statements; second, identifying, reconciling and eliminating intra-governmental transactions; and, third, assisting the agencies in reconciling their fund balances with Treasury records.

We also worked to modernize and improve the systems used to report both the budget execution information and the accrual-based information contained in this report.

It is essential that the information received from the agencies be consistent with the information presented in their financial statements. Our auditors, GAO, reported this year, however, that they could not fully verify the information provided to us as consistent with the information in agency-level financial statements. This finding comes in spite of a process that requires agency chief financial officers to prepare, and inspectors general to review, a detailed comprehensive worksheet that crosswalks the data submitted to Treasury to individual line items on the agency's audited financial status. Clearly, this process needs to be reviewed.

Additional improvements have been made in the accuracy of the 2000 opening net position balances. Over the last year, Treasury worked very closely with program agencies to reach agreement on opening balances. Last year, the unexplained opening balance differences were approximately \$70 billion. This year, the unexplained differences for all agencies are approximately \$8 billion, evidencing improvement but, nonetheless, not an acceptable result.

We continue to take actions that improve data accuracy. A clear indication of progress was a reduction in the number of adjustments submitted during our review process from 575 for the previous year to 280 this year. The audits of the agency's financial statements have disclosed that the agencies continue to have difficulties identifying transactions with each other so that the transactions can be reconciled or eliminated for governmentwide reporting. If these transactions are not eliminated, total government assets, liabilities, revenues and expenses are misstated by the net amount of these transactions.

For the second year in a row, we were able to resolve the intra-governmental elimination issue for borrowing and investment transactions between program agencies and either the Bureau of the Public Debt or the Federal Financing Bank, a subset of the total governmental elimination issue. We lack specific explanations this year for only about \$3 million in such transactions out of a total of more than \$2 trillion outstanding.

This past year we also focused on addressing elimination issues regarding transactions between the program agencies and the Office of Personnel Management and the Department of Labor as well as the buying and selling transactions between agencies themselves. While we still have considerable work to do, we were able to significantly reduce the unexplained differences. We will work with agencies to formulate additional guidance based on the progress made this year.

With regard to buying and selling transactions between Federal agencies, Treasury has been working with the consultants to develop a buy-sell model that allows for eliminating such transactions. This model produced significant improvements this year, and we hope that next year the information will be sufficient to justify that the buy-sell transactions are immaterial at the governmentwide level.

Treasury continues to assist agencies in reconciling their fund balance amount with the amount reported to them. Today, the discrepancies most often are a result of timing differences and are resolved in a few monthly cycles.

In order to capitalize on improvements over the next few years, program agencies' reconciliations of fund balances must be a management priority and a routine ongoing accounting function. Agencies have made much progress in institutionalizing the process. To further facilitate this, Treasury is redesigning its systems to simplify the process to improve the availability of the data.

As you have heard, the current State of Federal financial reporting is not satisfactory. I am confident that a creative and committed effort by Treasury, program agencies, OMB, the CFO council and GAO, combined with adequate funding, can result in breakthrough changes.

In the short-term, we will make the changes that can be made to improve the preparation of the financial report. For the long-term, we are taking considerably more aggressive action.

Our most critical short-term challenges remain in three areas pertaining to preparation of the report. In the area of intergovernmental transactions at the request of the principal agencies, the joint financial management improvement program has initiated an effort to better define the problems and identify areas for focused attention. That is a beginning.

Additionally, we must fully develop the process for a complete reconciliation of the budget results with the financial statements' results of operations. We will also provide comparative financial statements at the appropriate time. And, one other area where usefulness can be dramatically improved is in the content of our reports; and we will reach out to stakeholders to find out what they believe is most useful.

Recently, we modified our systems and processes to provide agencies with easier and quicker access to certain budgetary information through the Internet. Agencies can now obtain Web-based access to important accounting information. As we roll this out governmentwide over the next 7 months, we are confident that this will go a long way toward assisting agencies with reconciling their fund balances and outline our approach to long-term solutions for redesigning the governmentwide accounting process.

We continue to improve our Standard General Ledger based reporting systems. Just as manufacturers reject components that do not meet specifications, our new reporting systems reject reports that do not meet specifications of the U.S. Standard General Ledger. As agencies move toward SGL-compliant accounting systems, the reports will continue to improve.

The FACTS II system, jointly developed with OMB, became fully operational with year-end 1999 reporting. FACTS II loads the prior

year results directly into the budget formulation process, which helps budget offices ensure that the budget process begins with what actually happened the previous year.

Improving financial management and accountability is a top priority for Treasury, and we are prepared to take a lead role. We will work closely with OMB and program agencies to raise the bar in financial management improvements.

As I mentioned at the beginning of my testimony, Treasury, OMB and GAO will reevaluate the process we use to prepare the governmentwide financial statements. Our review may indicate that it may not be workable, within 30 days of completing agency financial statements, to produce the financial report, complete the consistency evaluation, and obtain an audit opinion.

Our goals include: accelerating the timeframes for issuing year-end audited financial statements, providing for comparative reporting, and moving toward the preparation of quarterly statements by program agencies. We will also consider new ideas such as audit committees and the use of pro forma financial statements with budget submissions.

Our ultimate success will be achieved when we reliably and accurately report on the distinctly different financial activities of many agencies of government as if they were one entity, and do so in a timeframe and a manner that is truly useful.

Thank you, Mr. Chairman. That concludes my formal remarks. I will be happy to take questions.

Mr. HORN. Well, we thank you, and we hope that some of the optimism in your statement will come to reality next year.

[The prepared statement of Mr. Hammond follows:]

STATEMENT OF DONALD V. HAMMOND
Acting Under Secretary for Domestic Finance
Department of the Treasury
BEFORE THE HOUSE GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS
U. S. HOUSE OF REPRESENTATIVES

March 30, 2001

FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT
FISCAL YEAR 2000

Mr. Chairman and members of the Subcommittee, I am pleased to appear today to discuss the Financial Report of the United States Government. I would like to thank you, Mr. Chairman, Ms. Schakowsky, and other members of the Subcommittee for focusing on improving Federal Government financial accountability and reporting.

The Department of the Treasury is dedicated to producing useful Governmentwide financial statements and has devoted considerable resources to this effort. While we are pleased to issue the FY 2000 Financial Report on time again this year, reporting not fully reliable financial results six months after the close of a fiscal year is simply not good enough. Working with the federal community, we have made incremental progress each year but incremental progress may not prove to be sufficient. We are committed to improving the process to make the financial statements more useful.

Treasury, in conjunction with the Office of Management and Budget (OMB), and the General Accounting Office (GAO), will conduct a comprehensive review of the financial statement production process. While we have made significant progress in performing the consolidation, particularly with respect to resolving differences in net position, classifying agency activity, reducing the number of adjusting entries, and making certain intergovernmental eliminations, the remaining challenges, especially with respect to consistency and intergovernmental eliminations, warrant a fresh look. This review will lead to recommended changes and improvements. Should any require legislation, we will report them to you. Additionally, later this year, Treasury will implement the first phase of our multi-year revamping of Governmentwide central accounting systems and processes for reporting budget execution information. This initiative will improve data access, reduce redundant reporting, and eliminate time-consuming reconciliations. This is a critical first step to improving overall federal financial management.

BACKGROUND

The Department of the Treasury continues to be a strong advocate for the preparation of financial statements by Government agencies and for Governmentwide consolidated financial statements. The Government Management Reform Act of 1994 (GMRA) requires that not later than March 31 of each year, the Secretary of the Treasury, in coordination with the OMB Director, shall prepare and submit to the President and the Congress audited financial statements for the preceding fiscal year. The statements cover all accounts and associated activities of the executive branch of the United States Government and are prepared in accordance with generally accepted accounting principles, as established by the Federal Accounting Standards Advisory Board (FASAB). The Financial Report of the United States Government for fiscal year 2000, which includes the financial statements, provides information to the President, the Congress, and the American people about the Government's financial position, the cost of its operations, its sources of financing, and stewardship information.

PROGRESS MADE

We are committed to producing financial statements that meet FASAB standards and provide timely, accurate, reliable and, most importantly, useful information. Since issuing the first consolidated financial statements just three years ago, we have been working closely with OMB, GAO, and the program agencies to improve the quality of the Financial Report. Within Treasury, the Financial Management Service (FMS) is responsible for producing these statements. This past year, FMS continued to focus on three critically important areas: first, ensuring that the financial information reported to us by the program agencies is consistent with the information in the agencies' own financial statements; second, identifying, reconciling and eliminating intragovernmental transactions; and, third, assisting agencies in reconciling their fund balances with Treasury records. We also worked to modernize and improve the systems used to report both the budget execution information and the accrual based information contained in this report. We had improvement in each of these areas.

Consistency and Accuracy of Financial Information

The process of preparing the Financial Report begins in early February when about 130 Federal departments, independent agencies and commissions electronically transmit to Treasury approximately 2000 adjusted trial balances and related notes. It is essential that this information be consistent with the information presented in the agencies' financial statements, since the audit of the Governmentwide financial statements relies in large part on the separate audits of the agency-level financial statements. Our auditors, GAO reported this year, however, that they couldn't fully verify the information provided to us as consistent with the information in agency-level financial statements. This finding comes in spite of a process that requires agency Chief Financial Officers to prepare and Inspectors General to review a detailed, comprehensive worksheet that crosswalks the data submitted to Treasury to individual

line items on the agency's audited financial statements. This process resulted in an unreconciled amount of \$7.3 billion in changes in net position.

Additional improvements have been made in the accuracy of FY 2000 opening net position balances. Over the last year, Treasury worked very closely with program agencies to reach agreement on opening balances. An agency's opening net position balance as recorded by Treasury should agree with the agency's opening balance submission. Any difference should be explainable so adjustments can be made. Last year, the unexplained opening balance differences were approximately \$70 billion. This year, considering an opening net position of over \$6 trillion, the unexplained differences for all agencies are approximately \$8 billion, with the Departments of Agriculture and Transportation accounting for \$7 billion of the differences.

We continue to take actions that improve data accuracy. As agencies become more comfortable with the data reporting requirements, we will experience even greater improvement. A clear indication of progress was a reduction in the number of adjustments submitted during our review process from 575 for the fiscal 1999 Financial Report to 280 this year.

Elimination of Intragovernmental Transactions

The audits of the agencies' financial statements have disclosed that the agencies continue to have difficulties identifying transactions with each other so the transactions can be reconciled or "eliminated" for Governmentwide reporting. If these transactions are not eliminated, total Government assets, liabilities, revenues, and expenses are misstated by the net amount of these transactions. While GAO reports a \$250 billion absolute value of reported differences, the net amount for the fiscal year 2000 statements was \$1 billion after Treasury's reconciliation.

Excellent progress continues to be made in reconciling certain intragovernmental transactions that represent the largest dollar amounts. As a result, these transactions can be properly accounted for and reported in agency financial statements and also properly identified and eliminated at the consolidated financial report level. For the second year in a row, we were able to resolve the intragovernmental elimination issue for borrowing and investment transactions between program agencies and either the Bureau of the Public Debt or the Federal Financing Bank. We lack specific explanations for only about \$3 million in Public Debt and Federal Financing Bank borrowing and investments out of a total of more than \$2 trillion. We are confident that these transactions have no material impact on the financial statements, since the values presented in the statements are rounded to the nearest hundred million.

This year, we focused on addressing issues regarding transactions between the program agencies and the Office of Personnel Management (OPM) and the Department of Labor as well as buying and selling transactions between program agencies. During

FY 2000, Treasury established new procedures for reconciling transactions with OPM relating to employee retirement benefits. To assist agencies and OPM to reconcile transactions in pension, health and insurance benefits; Treasury, OMB and OPM implemented additional guidance and disclosure requirements. These disclosures helped resolve differences and are required to be reviewed and audited by the agencies' respective auditors. While we still have work to do, we were able to significantly reduce the unexplained differences from \$1.5 billion in FY 1999 to \$.6 billion in FY 2000. We will work with agencies to formulate additional guidance based on the progress we made this year.

With regard to buying and selling transactions between Federal agencies, Treasury has been working with a consultant to develop a buy/sell model that allows for eliminating such transactions and moving the costs to the end user. This model produced significant improvements this year and we hope that next year the information will be sufficient to justify that the buy/sell transactions are immaterial at the Governmentwide level.

Reconciliation of Fund Balances

Treasury continues to assist agencies in reconciling their fund balance amount with the amount reported to them by Treasury. The fund balance amount is an agency-level asset account that reflects the available budget spending authority of that agency. Treasury has implemented an internet-based Information Access System that provides agencies information about potential deposit and disbursement discrepancies. Agencies are responsible for resolving the differences in a timely fashion. This year, Treasury provided special assistance to the Departments of Agriculture and Defense and the Postal Service in identifying and/or writing off very old differences. Today, the discrepancies most often are a result of timing differences and are resolved in a few monthly cycles. On a Governmentwide basis, as of September 30, 2000, there were about \$.5 billion, \$1.1 billion, and \$8.5 billion of net differences between our records and those of the program agencies in three key areas – Deposits, Disbursements, and Checks Issued, respectively. For the most part, these differences are timing differences (much like your checkbook and your bank statement) and most are quickly resolved by the agencies. For example, when you review only those differences that are 6 months old or greater, the differences are \$.2 billion, \$34 million, and \$66 million respectively.

In order to capitalize on improvements over the last few years, program agencies' reconciliation of fund balances must be a management priority and a routine, on-going accounting function. Agencies have made much progress in institutionalizing the process. To further facilitate this, as more fully discussed later in my statement, Treasury is redesigning its systems to simplify the process to improve the availability of the data.

PLANNED IMPROVEMENTS

As you have heard, the current state of Federal financial reporting is not satisfactory. I am confident that a creative and committed effort by Treasury, program agencies, OMB, the CFO Council, and GAO combined with adequate funding can result in breakthrough changes. In the short term, we will make the changes that can be made to improve the preparation of the Financial Report of the United States Government. For the long term, we are taking considerably more aggressive action.

Short-term

Our most critical short-term challenges remain in the three areas pertaining to preparation of the Financial Report that I have already discussed. As indicated in the message from the Secretary in this Financial Report, we intend to conduct a comprehensive review of the processes necessary to produce the financial statements. In the area of intragovernmental transactions, at the request of the principal agencies, the Joint Financial Management Improvement Program has initiated an effort to better define the problems and identify areas for focused attention. While the outcome of these reviews is unknown, it is certain that it would permit Governmentwide statements to be prepared earlier than 6 months after the close of the fiscal year.

Additionally, we must fully develop the process for a complete reconciliation of the budget results with the financial statements' results of operations. An analysis by our consultant and the fact that the unreconciled amount is \$7.2 billion this year indicates we are on the right track. As we continue to reduce the unreconciled transactions reported on the Statement of Operations and Changes in Net Position, we will be fine-tuning the reconciliation report. We will also provide comparative financial statements at the appropriate time. One other area where usefulness can be dramatically improved is in the content of our reports. Adding consolidating schedules containing agency financial results to this report would make it much more informative. While this is not presently within our capability, we will be looking for ways to capture this data in the future.

Recently, we modified our systems and processes to provide agencies with easier and quicker access to certain budgetary information through the Internet. Using our legacy central accounting system, agencies can obtain web-based access to such information as statements of differences, and ledger and trial balances. With this

system, agencies can access their statement of differences the day after submitting their month-end reports and then submit corrected reports to resolve any out-of-balance conditions during the same accounting month. As we roll this out Governmentwide over the next 7 months, we are confident that this will go a long way toward assisting agencies with reconciling their fund balances more timely. Furthermore, Governmentwide implementation also provides a good preview of our long-term approach to redesigning Governmentwide accounting processes.

Long-term

Treasury's new Governmentwide budgetary accounting system will be implemented in a modular, phased approach over the next several years. The redesigned system will be internet-based, and users will be able to access the FMS portal 24 hours a day, 7 days a week. We will capture necessary accounting information, including the Treasury Account Symbol, at the initiation of the business transaction instead of after the funds have left the Government, as is presently the case. This will reduce redundant reporting among the agencies, OMB and the Treasury. Also, it will reduce after-the-fact reconciliations for payment and collection transactions. Additionally, Treasury's plan is to provide a daily account statement for each Treasury Account Symbol. The statement would show the beginning balances, increases and decreases to the account based on collections or disbursements, and the closing balance. With that level of information, agencies will know their fund balances on a daily basis. A fully operational system will provide agencies one-stop shopping for accounting data and information retrieval.

We continue to improve our Standard General Ledger based reporting systems. Using the Federal Financial Management Improvement Act of 1996 as a base, these systems strive to collect data needed by OMB and GAO directly from agency accounting systems. Just as manufacturers reject components that do not meet specifications, our new reporting systems reject reports that do not meet specifications of the U.S. Standard General Ledger. As agencies move toward Standard General Ledger compliant accounting systems, the reports continue to improve.

The FACTS II system, jointly developed with OMB, became fully operational with year-end 1999 reporting. Agencies submit one budget execution report for both OMB and Treasury. This provides consistency between OMB and Treasury numbers. Most importantly, FACTS II loads the prior year results directly into the budget formulation process, which help budget offices ensure that the budget process begins with what actually happened the previous year.

CHALLENGES AND CONCLUSION

Improving financial management and accountability is a top priority for Treasury

and we are prepared to take a lead role. We will work closely with OMB and program agencies to raise the bar in financial management improvements. As I mentioned at the beginning of my testimony, Treasury, OMB, and GAO will reevaluate the process we use to prepare the Governmentwide financial statements. Where that will take us and how much of the current process we retain remains to be seen. Our review may indicate that it may not be workable within 30 days of completing agency financial statements to produce the Financial Report, complete the consistency evaluation, and obtain an audit opinion. Our goals include accelerating the timeframes for issuing year-end audited financial statements, providing for comparative reporting, and moving toward the preparation of quarterly statements by program agencies. We will also consider new ideas such as audit committees and the use of pro forma financial statements with budget submissions. These changes will require sufficient funding in the future that we will request at the appropriate times.

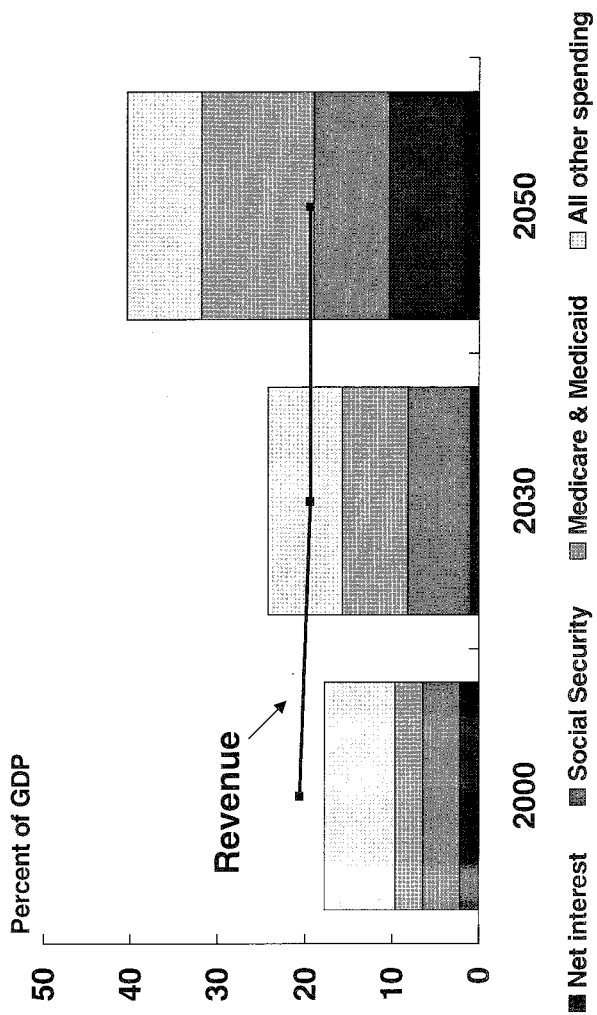
Our ultimate success will be achieved when we reliably and accurately report on the distinctly different financial activities of many agencies of Government as if they were one entity and do so in a time frame and a manner that is truly useful.

Thank you, Mr. Chairman. This concludes my formal remarks and I would be happy to respond to questions.

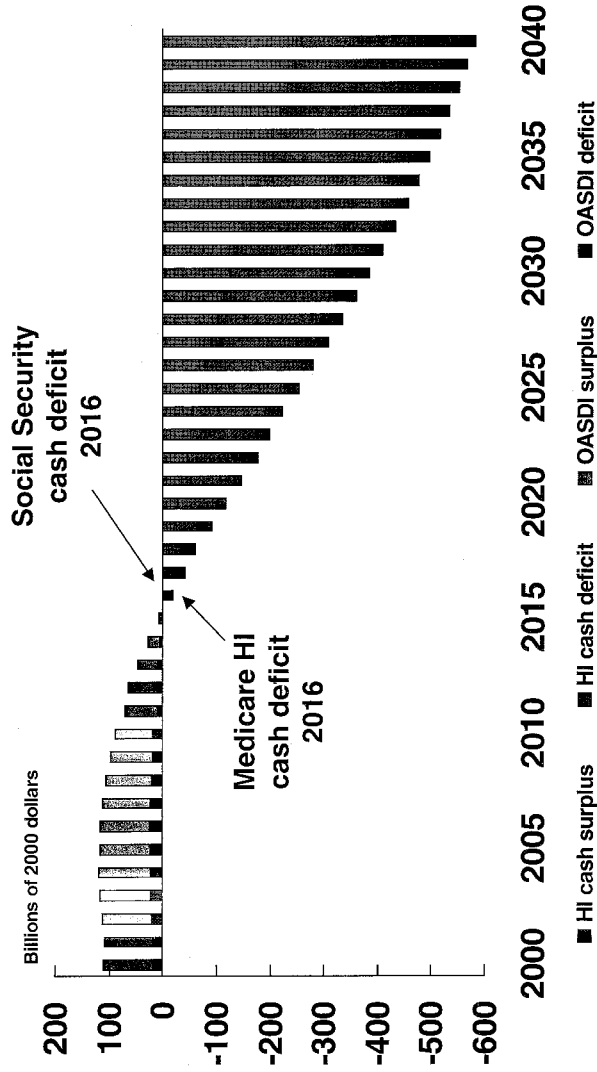
Medicare Spending Estimates

	2000 Trustees	2001 Trustees
HI Outgo Exceeds Tax Income	2010	2016
HI Trust Fund Assets Are Exhausted	2025	2029
HI Actuarial Balance	-1.21	-1.97
Difference between HI Cost and Income Rates in 2075	-3.28	-7.35
HI and SMI as a % of GDP in 2075	5.3	8.5

Composition of Federal Spending Under
“Save the Social Security Surpluses”
Simulation



Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits as Baby Boomers Begin to Retire



Mr. HORN. We now have the Honorable Mitch Daniels, Director, Office of Management and Budget. Mr. Daniels.

Mr. WALKER. I don't know if he is here yet, Mr. Chairman. You may want to go into Q and A.

Mr. HORN. We have him as the second panel. I don't know what "here" and "there" did on the scheduling, so we will go to questions then. It would have been better if we had all three of you there.

So, let's start with Mr. Putnam, and then I will do it after 10 or 15 minutes, and then he will do it again.

Mr. PUTNAM. Thank you, Mr. Chairman. I thank the gentlemen for their testimony.

One of the problems that Mr. Walker highlighted was that of resolving difficulties and reconciling intergovernmental transactions and the information system security weaknesses. After we have come out of the year 2000 and spent—I don't even know if we know, because we don't have auditable statements, how much we spent to get everybody Y2K ready, presumably that means we upgraded to the latest and best and most effective computer and information technologies. What are the outstanding information security issues, how can we address those and what do you presume the cost of those upgrades to be?

Mr. WALKER. Let me take a shot, Mr. Putnam.

First, you are correct that there was a tremendous amount of financial and human resources focused on the Y2K effort, which was a date certain, so you had to get it done by a certain date. In fact, quite frankly, I think that is evidence of how the government mobilized on a governmentwide basis, and it was a success story, where we actually avoided any major disruptions associated with Y2K.

While clearly there were some supplemental benefits that were achieved through those expenditures with regard to trying to upgrade a number of existing information technology systems and capabilities, the fact of the matter is that we still have throughout government too many systems that are legacies of the past; too many systems that are freestanding, non-integrated; too many systems that are designed based upon the individual wants of various entities, whether it be the numerous entities within the Department of Defense or the Agriculture Department, rather than looking at it on an enterprise-wide basis to really have an enterprise-based architecture that is focused on the needs of the entity as a whole, where you only have to enter the data once and where you have much more reliability not only from the standpoint of computer security but also for the accuracy of the information.

I don't have a particular estimate. I don't know, Jeff, if you do, of some of the estimates of the magnitude and the economics associated with it as it relates to dollars.

Mr. STEINHOFF. I have been told that roughly one-half of capital spending at the Federal, State and local level is on IT. At the Federal level this year, it is projected to be \$40 billion. At the heart of all of the issues, all of the problems on the chairman's chart today, are poor systems. Y2K fixed one part. It dealt with that date issue. But it did not deal with the underlying systems problems. We are going to have to make a major investment. It must be done in a very wise manner.

Mr. PUTNAM. Let me follow-up on that, because it occurs to me, and I am new to this process, but in the State legislature every year, every single year, we spent a fortune on information technology, and we fell further behind. Corporate people know that. Today you buy it, then it is obsolete. There has to be some better-coordinated way for us to get on top of that issue.

I would ask, if Congress were to pose the question, exactly what is the figure that all the Federal Government spends on information technology? Would that even be a determinable number?

Mr. STEINHOFF. I would want to get back to you on that, but the number that I have heard is that \$40 billion will be in the budget this year.

Mr. WALKER. That is probably the hard dollar number, rather than necessarily the costs associated with all the people who are working on information technology. We will review that, Mr. Putnam, and get back to you.

[NOTE.—The publication entitled, "The 2000 Financial Report of the U.S. Government," may be found in subcommittee files.]

Mr. WALKER. I do think it is important to note that in order for us to be able to make sure that, ultimately, Federal managers and leaders have timely, accurate and useful information to make informed decisions day to day, a big part of that is going to be to upgrade the existing systems that are out there and to integrate them while we are also dealing with security issues and related matters.

In that regard, I might add, in the private sector, frankly, things would not be done the way that sometimes they are done in the government. You have to have a mechanism at the very top where somebody can say yes or no on a systems project, either yes, you are going to do it, or no, you are not going to do it, based upon an overall master plan, based upon an enterprise-based architecture meeting certain minimum standards. In addition, you have to be able to have control of the money.

Therefore, I think, among other things, what that means is we do need a Federal CIO. In addition to that, the CIO's in the individual departments and agencies need to have more input on whether or not systems are going to move forward or not based upon an enterprise-based architecture and ought to have more authority on whether or not money is going to be spent. Because, all too frequently, what ends up happening, it happens in the private sector, too, if you don't control it, you have a number of different individuals and entities come up with what they want, and they will end up having their own individual initiatives under way to try to design systems that they want, which is far in excess of what they need, but they are not integrated with or consistent with the overall enterprise architecture and plan.

This is a particular challenge at the Defense Department, and I expect in the not-too-distant future I will be making some recommendations about what needs to be done to try to deal with that.

Mr. PUTNAM. Is the current congressional budgeting and appropriations process effective in helping to accomplish the overall efficiency goals? In other words, by having an annual budget and the requirements for the agency submissions for requests, the President's submission of his budget, the timeliness of our budget proc-

ess, which is then followed by the actual appropriations process, are there congressional reforms that could be made that would support your efforts to increase efficiency? And in the course of that, if you would, comment on the prospect of a multiyear or 2 year Federal budget.

Mr. WALKER. Well, I do think we need to do things differently, not only in the executive branch in certain regards, but also the legislative branch; and I do think we need to look at the mechanisms that are in place for reviewing and approving the undertaking and funding of major projects.

For example—I will give you one example. Yesterday, I had a meeting with 18 inspectors general, a State auditor and county and local auditors. One of the reasons I did that is I pulled them all together for 2 days in Washington to talk about mutual challenges, of which we have a number.

One of our mutual challenges is in the area of computer security; and one of our mutual challenges is in the area of how you get control of all these IT expenditures. One of the things I found is, as many times is the case, sometimes the States are way ahead of the Federal Government. Sometimes the Federal Government is a lag indicator.

In this regard, there were several of the States that talked about the fact that not only do they have a CIO but they have a council mechanism in place that, before any major IT projects can be funded or undertaken, they have to be reviewed and approved by a body of qualified parties, independent parties, and they have the authority to say yes or no. And if they say no, there is no money that goes for that project.

I am happy, we at the GAO will be happy to think about some of the things we think make sense in this area not only from the standpoint of the executive branch, but also for the legislative branch as well. But I think changes have to occur on both ends of Pennsylvania Avenue.

Mr. HORN. Very good. Thank you. I agree with you completely.

Does the gentleman have some more questions on this one, or do you want to go to another?

Mr. PUTNAM. If I may.

Mr. HORN. Please.

Mr. PUTNAM. Is it possible, considering the nature of the duties and responsibilities of the Federal Government, the security issues, the secrecy issues that are part and parcel of budgets like the Department of Defense, recognizing that we have a long way to go to become better, but is it possible at the end of the day in a perfect world for the U.S. Government to produce a true, clean financial statement that comports with traditional accounting standards?

Mr. WALKER. Yes, that is possible. I fully expect that it will end up happening during my term of office, which I have 12½ years left. I would like for it to happen early in my term of office.

But, I think what is important, Mr. Putnam, and I think it is an excellent question, is that it is not just getting a clean opinion. That can be a superficial victory. We need to be able to deal with the substance, not just the form. We need to make sure that we have the right kind of systems, strong controls, appropriate compliance mechanisms, and we need to have the data now, not 5 to 6

months after the end of the year. Because, you know, managers have to be able to make decisions not only about resources today, but anticipating problems for tomorrow. It is not just oversight, it is foresight that we need this information for.

So, yes, I think we can get there. I think we will get there, and I think I am encouraged by the fact that the Secretary of the Treasury, the Director of OMB and myself, who are the three principals of the joint financial management improvement program, have agreed to get together to try to come up with a game plan to help us get there. That is the first time that happened. I was pleased they accepted my proposal on that, and I am looking forward to getting together to do that.

Mr. HAMMOND. If I could add to that a little, I think it has always historically been a matter of emphasis. If you look at other areas of financial reporting in the Federal Government, you find that there is reason for great optimism.

We report budget results within 15 workdays of the end of the fiscal year. Those are reliable. We report daily cash positions in less than 24 hours, showing all the cash activity for the previous day. We report on the entire public debt outstanding within 3 working days of the close of the previous month, and that is done on a financial accounting basis.

So, I think there is potential—and we have seen evidence of doing this in a reliable form. The question now is emphasis and making sure that the systems today match the needs of financial accounting going forward.

Mr. WALKER. If I can followup on Don's point, a couple of things. No. 1, the Federal Government historically has been focused on two things when you are dealing with accounting, cash—and cash is important no matter what sector you are in—and, second, the budget. There are all kinds of systems that exist out there, and have existed out there for years, where people watch their budget, because, either they want to make sure they spend it all or make sure they don't violate the applicable limits, obviously. So there is a lot out there already on the budget side.

But what has not been out there, and there was no legal requirement for it to really be out there until the new financial management reforms came into place, were the traditional accounting systems that resulted in accrual-based financial statements that resulted in periodic reporting like the State and local governments have had for years and like the private sector has had for decades.

I also think it is important to note that GAO does give clean opinions, despite some rumors to the contrary. In fact, we have given a clean opinion on the Bureau of Public Debt for several years, the FDIC for several years, and, for the first time, gave a clean opinion for the Internal Revenue Service financial statements this year, although they, like many other agencies, have numerous material control weaknesses, meaning the IRS has significant compliance problems, and so they have still got these underlying problems.

It is possible, I think we will get there, but it is going to take the combined efforts of a number of parties, and some time to get us to where we need to be—and some money too, I might add.

Mr. PUTNAM. Thank you, Mr. Chairman. I might propose to the Ways and Means Committee we could make a lot of money by letting individual CPAs around the country bid on the right to audit the IRS.

Mr. HORN. We will have Commissioner Rossotti this coming week, and I am sure you can pose that question.

Any other items you want to pursue?

Mr. PUTNAM. I will let you go ahead.

Mr. HORN. Let me ask about the trustee reports. The Comptroller General has been on some of those boards in his career, Social Security, Medicare, and the administration has issued its annual trustee reports on Social Security and Medicare in time for certain information to be included in the government's financial report. Last year, the GAO emphasized the need for the trustee reports to be released prior to the statutory date of April 1st, so that information could be included in the government's financial year. The administration issued these reports on March 19, 2001, and therefore, current information was included in the government's financial report. What do you believe should be done?

Mr. WALKER. Well, first, I want to acknowledge progress for this year, and I want to thank Don and the others that were involved in trying to make sure that this happened.

What we do have is what I would call a subsequent events footnote in the consolidated financial statements this year that provides information, summary information, from the most recent trustee's report of Social Security and Medicare, and compares it to the financial statement information.

I think that is a positive step, first step.

I do think, however, over time what needs to happen is we need to have the updated—the full updated information dealing with the Social Security and Medicare trustees' information in the notes to the financial statements, the consolidated information.

In addition, I think over time what we need to do is that we need to issue the consolidated financial statement report and our audit much quicker; and in order to make that happen, it means that, over time, the Social Security and Medicare trustees are going to have to start issuing numbers as of September 30, which is fiscal year end, rather than as of December 31, which is calendar year. I think that is doable.

I have had some informal conversations with some of the actuaries. But I think that we need to enhance the disclosures, we need to accelerate the timeframe, and we need to make sure that we have more than a subsequent events note in there, that we have more fuller disclosure of information in there than is the case now.

Mr. HORN. I take it you would favor audited reports out of the trustees?

Mr. WALKER. I think we have to recognize—I think the projections, and that is what they are, the projections that the Social Security and Medicare trustees do should be subject to some type of audit procedures. At the same point in time, there are limits as to what those procedures should be and what they can be.

Obviously, when you are dealing with historical financial information, then the degree of confidence that one should expect to be attained and that can be attained through auditing procedures is

much higher. When you are dealing with projection information, I think that there needs to be an independent review of such things as, are the methods generally acceptable, are the assumptions reasonable, is the math proper? Because last year, not this year, but last year, Medicare actually had to reissue its numbers because there was a material misstatement in the numbers. I think that is something that we have to try to avoid.

The other thing I think we have to recognize is that—I would argue that, if you are looking at American citizens, that probably some of the most important information in this consolidated financial statement report is not the value of assets the Federal Government has but the projected financial condition of the Social Security and Medicare programs on which they are counting. I think it is critically important that when we look to consolidate this report and make sure it maximizes its usefulness that we think about it from the standpoint of the citizenry, because that is ultimately who we are serving. I think it is important that we continue to make progress there.

Mr. HORN. You recently testified before the Senate Committee on the Budget that the government today is moving from balancing the budget to balancing the fiscal risk. As you point out, this increases the importance of providing Congress and policymakers with timely, accurate and useful financial administration and information for use in deliberations involving long-range fiscal policy challenges facing our Nation.

What do you see as some of the fundamental fiscal challenges that do face the Nation?

Mr. WALKER. Well, if I can use a couple of boards, Mr. Chairman, I will be happy to oblige you on that. I appreciate that question. I didn't know if I would get to use them or not, but this question gives me a chance.

Mr. WALKER. Right now, we all recognize—right now we are living in a time of surpluses. However, we know two things for certain. While surplus projections cannot be totally relied upon, we need to do them, they have to be based on a number of assumption. There are two certainties.

First, we know we face a demographic tidal wave because the people are already alive. We know that the first baby boomers are going to start retiring in 2011, that is when they reach 65; some may retire earlier, some later, but the first one reaches 65 in 2011, which is just beyond the 10-year projection period. We also know that health costs are again on the rise at a much faster rate than historically has been the case.

What this simulation will show you, this is a GAO simulation, it will show you that if Congress saves every penny of the Social Security surplus, but if either through tax cuts or spending increases, all of the ongoing budget surplus is spent or consumed one way or the other, this is our future in 2030 and 2050. By year 2030, we will have to cut discretionary spending by about 50 percent. And by—

Mr. HORN. By 15, was it?

Mr. WALKER. 50. And by year 2050, we won't have any main or discretionary spending, or money to pay Medicare and Medicaid.

Now, that is pretty dramatic. Now, these are based upon the growth rates of CBO, which is pretty healthy growth.

The fact is that we need to recognize that while we are in good shape today, we have major challenges in the long-run. So it is very important that we have financial statement information, and, I would argue budget information. More information has to be made available through the budget process to think about the long-term implications of current decisions, because there are certain things that we might be able to afford today, but we are not going to be able to sustain tomorrow. And it also means that we need to get on with reforming entitlement programs, because it is only going to get tougher the longer the time passes in that regard.

I am pleased to see, by the way, in the financial statement, the management discussion analysis, that there was recognition of that fact as well in this year's financial report.

Don, do you want to comment?

Mr. HAMMOND. Well, I think an analysis of the flows within government is a very important element of financial reporting. For these reports to be useful, they have to provide not only the data, but also some benchmarks of analysis to indicate how these things measure up. We tried to do some of that this year for, I think in many senses the first time, and there is obviously more that can be done.

Mr. WALKER. Real quickly, Mr. Chairman, this chart shows what happens to Social Security and Medicare in the outyears. Right, now the blue, we are in times of surplus; the red, obviously, is times of deficit. Look how rapidly that accelerates starting shortly after baby boomers begin retiring.

The key on the entitlement programs, by the way, in our view is not solvency, it is sustainability. It is what percentage of the budget and what percentage of the economy do these programs represent? Solvency is a legal issue more than anything else; it is not an economic issue. It does not have economic substance. We need to focus on economic substance rather than legal solvency.

Mr. HORN. Any thoughts on that, Secretary Hammond?

Mr. HAMMOND. I am afraid that is out of the range of my expertise. We have some very bright people at Treasury who deal with some of the more important issues revolving around Social Security.

Mr. HORN. Why don't we have the question put to them, and respond, and put it at this point in the record?

Mr. HAMMOND. We would be happy to.

Mr. HORN. Great.

Mr. WALKER. I am pleased to say that I think in the management discussion analysis portion that was done by Treasury, that they do acknowledge that sustainability is in question, yes.

Mr. HORN. One of the problems in this town is that OMB often has some economic figures, and CBO on the Hill and Congress has others. How can we get that balance where everybody agrees these are the numbers?

Mr. WALKER. Well, first, if you look at the 10-year projections that are currently being used for the basis of the current debates in Congress about tax cuts, spending and other types of activities, the projections or the assumptions that are being used by OMB

and CBO are remarkably similar. I mean they are very, very close, probably closer than they have about ever been. Obviously, we need to have those kinds of projections, because we need to have something to be able to try to make some informed judgments. At the same time, I think we have to recognize that the further out you go, the less certainty there can be with regard to what those projections are.

I would, however, reinforce that these projections, I think, have a higher degree of reliability. Why? Because they deal with people, and we know the people are going to be here, and in the case of Social Security, we know what the promises are. Now, healthcare cost increases are a wild card. We don't really know that, but we do know they are going up, and we do know that our current system doesn't have effective means of controlling those healthcare costs.

Mr. HORN. Are there any other charts from the Comptroller General?

Mr. WALKER. Well, I will show you one more that emphasizes what I mean. Thank you, Mr. Chairman.

I think this depletes the inventory after this.

One of the disclosures that we have, which I do appreciate the Treasury Department's support and OMB's support to get this in here this year, is to talk about the difference between what historically had been in there, which is the prior year's report. And the most recent report that just gets issued about the same time as the consolidated financial statements. This year I think it got issued on March 19; last year it got issued 1 day after we issued the consolidation financial report, and we all looked foolish, frankly.

This shows you how significantly things can change in 1 year. This is the HI program or so-called Part A of the Medicare program, which is only part of the program. And you can see it is good news and bad news, what happened in this latest report that was issued on March 19.

The good news is from a solvency standpoint it looks like we are more solvent, and we are, based on these projections, that the date by which you have a situation where HI is going to have a negative cash-flow has been extended from 2010 to 2016. And, in fact, the Trust Fund is not expected to run out of assets until 2029, which is 4 years later than last year.

However, if you look below that line, you find that the long-range situation is much worse. The numbers are self-evident. But the one that I would bring to the fore is that the unfunded liability, which is not on here, the unfunded liability of the promises that have been made but are not funded for in just Part A of Medicare alone in the last year have gone up from \$2.6 trillion to \$4.6 trillion. And that is just Part A of Medicare, that doesn't count SMI.

This is very important information. This is very important information that ultimately we need to make sure is not relegated to a footnote and that we end up increasing the prominence and the timeliness of some of this information.

Mr. HORN. Well, we thank you. And get us a set of the materials so we can put it in the record of this hearing. And that will be, I am sure, looked at by quite a few people. We put it in parens, part A, which I think would clarify it a little bit.

The Director is here, so we will have him come out and make his presentation, and I would like for both of you to stay here. He is in our lounge here and watching what you are doing. So if you both will stay, we will have some decent dialog, questions and answers with all of you.

We will put in the record at the beginning of this hearing the opening statement of the ranking Democrat, Ms. Schakowsky.

And we will also have, I believe, Secretary O'Neill's statement.

Mr. PUTNAM. Mr. Chairman, will the record be open for several days for testimony?

Mr. HORN. Yes, 7 days, for anybody that wants to put in testimony.

I am going to swear in the Director.

Is this your first appearance after your confirmation, or have you been to a few other ones?

Mr. DANIELS. There have been a few other opportunities.

Mr. HORN. Mr. Daniels, you say you have the truth, the whole truth and nothing but the truth on your testimony. Anybody behind you from OMB, we will swear them in too, so whatever you would like on it.

[Witnesses sworn.]

Mr. HORN. OK.

Mr. DANIELS. With the Chair's pleasure, I will read, then, a short statement.

Mr. HORN. Well, we would like to limit it to about 15 minutes.

Mr. DANIELS. I was thinking 5.

Mr. HORN. Of course, would like to see a dialog here. That is how we learn things. Not that your statement isn't very learned.

Mr. DANIELS. It was already my plan to abbreviate what we submitted for the record.

STATEMENT OF MITCH DANIELS, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DANIELS. As the committee might imagine, our priority has been and is for at least the next several days to deliver to the Congress the President's budget. But we are already embarked on the design and construction of what we hope will be an ambitious management reform agenda, and we did give the outlines of that in the President's budget blueprint at the end of February. Along with the top career professionals at OMB, our new team spent Saturday, on St. Patrick's Day, in a day-long review of management issues and opportunities facing the Federal Government, and we are at work on a strategy and a prioritization among those that we intend to present to the Congress later on this year, and hold ourselves accountable for achieving.

We note that over the last decade, Congress has built a new legislative framework for financial management performance measurement, better and more effective government generally, and we know this morning's emphasis is on financial management, certainly a prerequisite of sine qua non of much of the rest of the progress we hope and intend to make.

I reviewed the earlier testimony and it noted directly that the Federal Government has made some progress in this area recently. We can all be glad about the growth in the number of agencies who

have been able at least to secure the designation of having clean audits, and it is I think our expectation, as yours, that within the next few years, all agencies will achieve that status. I guess I would simply note that my view of that is only a first step, not to be equated with sound financial management. Audits are a means and a tool, not an end to themselves. Clean opinions are important and, as I said, a prerequisite to public accountability, but in and of themselves do not translate into good government.

As we have seen already, agencies can get the good housekeeping seal of a clean audit opinion while remaining in a state of unsatisfactory management status. Some of the agencies on Comptroller Walker's high-risk list, with problems of high-risk, have passed their audits and have passed for years.

I looked at the three that you have given your A grade on the subcommittee's report card—and, incidentally, I commend you for not joining the society-wide tendency to grade inflation, Mr. Chairman. You obviously reserved that grade for what you saw as the best, but two of those three have very, very substantial problems, visible for us all to see. One has been on the GAO high-risk list every year for over a decade. The other has difficulty, to say the least, in estimating the future costs of its most significant program which has experienced a 50 percent, that is to say, a \$4 billion increase or overrun only noted in the last few years. Those are your best performers.

I also note in these first weeks of looking at this issue that a clean opinion has sometimes been accomplished only at the—only through a process that my colleagues describe as heroic, or—I guess others have also made this observation. It tells me nothing, other than at least for one point in time, for 1 day, that a given agency had books that seemed to reconcile and balance. But, until that agency can generate similarly reliable information on a consistent basis, quarterly, monthly, maybe more often, I don't think any of us can rest or take too much comfort.

I suppose I will just close by saying that progress ought to be noted, some satisfaction ought to be taken. But I think we have to, as I know this committee does, keep that in full perspective, and a celebration ought to be postponed until we are sure there is a meaningful and lasting quality to these achievements. This administration is ready and eager to try to take the next step in what all parties, I know, recognize as a long-term exercise.

I thank you for this opportunity to be here, Mr. Chairman, and welcome your questions.

[The prepared statement of Mr. Daniels follows:]

Statement of
The Honorable Mitchell E. Daniels, Jr.
Director, Office of Management and Budget
Before the
Subcommittee on Government Efficiency, Financial Management, and
Intergovernmental Relations
of the Committee on Government Reform
US House of Representatives
March 30, 2001

Mr. Chairman and Members of the Subcommittee, my colleagues have reported on the results of the Fiscal Year (FY) 2000 audit of the Government-wide financial statements. I would like to take this opportunity to talk about my management agenda as Director of OMB. But first, I would like to congratulate this Subcommittee for pre-empting the budget release for the first time since the Government-wide financial statements have been prepared. Who knows, maybe one day soon they will be out at the same time!

As you know, I came to OMB from Eli Lilli and I have been onboard for just over two months—it already seems a lot longer. While most of my management team is in place, I am still looking for a Deputy Director for Management. I have very specific requirements and expectations for that individual, and I will take the time necessary to find the right person. I want someone with broad management experience in running an organization, someone who can deliver on the President's management agenda. I am also seeking a Controller for the Office of Federal Financial Management who will ensure that the Government's financial management policies provide the framework for linking budget and management decisions to performance.

While at this moment, my immediate priority is to deliver the budget to Congress 10 days from now, I can tell you that we are moving forward on an ambitious management reform agenda, based on the principles set forth in the President's Budget Blueprint. On St. Patrick's Day, OMB senior political and career executives participated in an all-day review of management issues. We laid the groundwork for this agenda, which I intend to present to Congress as a budget addendum later this summer.

During the last decade, Congress carefully built a legislative path to strengthen the framework for financial management and performance measurement. It is time to bring financial management in the Federal Government into the 21st century.

The President has called for the Government to be accountable, so citizens can judge our performance. As responsible stewards, we must do more to show how funding levels relate to performance levels. To date, the Government's progress in linking budgets and performance has been slow. Bringing about a much better linkage will be a priority of this Administration. Department and agency heads have been directed that their 2002 performance plans, which will be submitted to you shortly, include performance goals for Presidential initiatives and for Government-wide and agency-specific reform proposals. Making good on those promises—not just making those promises—will be the standard of this Administration.

Earlier testimony today suggests that the Federal Government has made some progress in improving its financial management. Eighteen, or three-fourths of the 24 largest agencies and departments, passed their audits last year. The President intends to hold agency heads responsible for passing their audits, a fundamental requirement in the private sector and a simple performance measurement for people to understand. We will keep the pressure on those agencies without clean opinions and work with them to resolve their systems and record-keeping deficiencies. Long before the end of this decade all agencies will have clean opinions. Does that mean we have good financial management?

I don't think so. Audits are simply a means—a tool—not an end unto themselves. Clean opinions are important for public accountability but do not necessarily translate to good Government. Agencies can pass their audits and still have serious management problems. Some of the agencies with program areas on GAO's latest High Risk passed their audits. In fact, if you look at the agencies that received straight "A's" on this Subcommittee's report card for financial management, two have serious management challenges.

- One's contract management program has been on GAO's High Risk list since 1990.
- The other has difficulty estimating future costs for its most significant program. It found a \$4 billion or 50 percent increase in the five-year projected cost of a major construction activity. This is particularly alarming since only six months ago the agency projected no cost growth. I'm not casting blame for the overrun; I want to know how the costs grew from zero to \$4 billion within just six months!

And those are the superstars, Mr. Chairman.

Several agencies have had—and lost—clean opinions in recent years, which suggests to me that the opinions reflect being clean at one point in time. Heroic efforts where people work night and day to get a clean opinion as of a certain date are meaningless exercises unless we dedicate ourselves to going the next step: to generate reliable financial information on a daily, weekly, monthly, and quarterly basis that we use to manage the Government.

There are other agencies that have yet to meet the minimum requirements necessary for good budget execution, let alone get a clean opinion. One agency overspent its FY 2000 budget by \$274 million because it was unable to accurately project and account for its costs. This was a violation of both law and one of the most basic and long-standing controls in Government—the Anti-Deficiency Act. Despite improvement efforts, this is the second such occurrence in the last four years.

Yes, there has been progress, but let's keep it in perspective. As we celebrate our accomplishments, let's make sure that there is an enduring quality to our achievements. We're doing pretty well on form—we need to concentrate on substance. The toughest part is yet to come. This Administration is ready to take the next step in what will be a long-term exercise to learn how to make decisions based on the financial and performance information available to us.

We must use this information to complement—not replace—the budget process. The budget should tell us how we want to perform, and accounting tells us how we actually did perform. Integrating them to better inform our choices and make our decisions is financial management.

Perhaps our greatest challenge will be to embed into the budget culture in Washington the habit of using financial information in real time to give our citizens the good Government they deserve.

Thank you, Mr. Chairman, for this opportunity to testify before the Subcommittee. I would be pleased to answer any questions from the Members.

Mr. HORN. I will yield to Mr. Putnam to question both individually. If the others would like to get up here so we can get a dialog, and see if there are different perspectives between the Comptroller General of the Treasury and OMB.

Mr. Putnam.

Mr. PUTNAM. Thank you, Mr. Chairman. I appreciate Mr. Daniels' and Mr. Walker's comments that a clean audit is not an end unto itself, but the sound management practices that produce it are really what we are after, and I am pleased that the President has made a priority of holding agency heads accountable.

How does he intend to do that? What practices will occur? What consequences will take place as a result of continued lack of management controls?

Mr. DANIELS. I am glad to hear you use the word "consequences," Congressman, because ultimately there have to be these, and this is an issue that ranges beyond simply the subject that engages our attention this morning. All too often the finding of inadequacy, for instance in the financial management context, or of failure of performance, which could relate to programmatic evaluations, has no consequences at all. We are intent at our agency on linking performance to the budget process, beginning this year, and we have an OMB-wide effort on now to make that real. I think this is the next essential step in a process that Congress has begun over the last several years with the passage of several important pieces of legislation, and we intend to be very serious about it.

Mr. PUTNAM. Could you go into some detail on this move toward performance-based budgeting? We will actually, if accomplished, have an opportunity to—for the legislative branch as policymakers to say, for example, for \$800 million a year we can meet 80 percent of the need for children on free or reduced lunch, for \$100 million we can meet 100 percent of the need, and we will be able to quantify those policy differences and the performance that each investment renders?

Mr. DANIELS. Well, 1 fine day, I hope we can. In the near-term, I would like to believe that at least we could begin the process of identifying, for example, among similar or even duplicative programs, which are performing best, which are performing most poorly, so that Congress at least would have the information necessary to redeploy funds from weak to strong performers. We are not even there yet. Of course, it may prove a challenge for the political process to take that last step of imposing consequences, because that has not always been the result, even on those occasions in the past when clear evidence of failed performance was available.

Mr. PUTNAM. Has the administration, through its new agency and department heads, undertaken a thorough strategic review of the mission of their agencies and given these new agency heads the opportunity to develop their mission and identify responsibilities that may have been given to them by the Congress, or have grown into their roles through time and evolution and bureaucratic creep and everything else, that they would like to devolve their agencies or departments so that we could then address it in the legislative branch?

Mr. DANIELS. I think an honest answer is there hasn't been time yet. Many of our departments and agencies, as you know, have only

one or two or a handful of the President's appointees in place. Now, strategic plans have been required of agencies and departments, and that is a starting point that provides a template, at least; and we use, for instance, the document that we found waiting for us at OMB as a starting point. But I would say, simply using that one example, that it was—it was not more than that, and we intend to make it considerably more specific and considerably more programmatic before we embrace it and seek to act on it.

Mr. PUTNAM. The agency's financial statements this year reported improper payments of over \$20 billion. This number is not even complete. GAO continued to find that most agencies have not estimated the magnitude of improper payments in their programs, nor have they comprehensively addressed the issue.

This is the part—I mean, this is really the core of the issue. When people get mad about government, it is the fact that we are still sending checks to people who have been dead for 3 years, it is the fact that we continue to buy \$800 toilet seats and all of these kinds of things. I really don't want to sound like the Pollyanna citrus grower from Florida that I am, but when you come into this business and you look at the magnitude of government and how we throw commas and zeroes around and mistake billions for trillions on a regular basis, that is the core of the cynicism about government and the reluctance of the American people to believe that we have our act together up here, and that the agencies have their act together, and that the people who are hardworking employees of those agencies have their act together.

What is being done and what can we do more of to get our hands around that?

Mr. DANIELS. I share your sense and the public's sense of dissatisfaction, or even fury at the findings.

Mr. HORN. We have to find a microphone that does work for you.

Mr. DANIELS. My technical assistant here has perhaps addressed the problem.

Mr. HORN. He has 12½ years to go.

Mr. DANIELS. I was observing that—I was certainly supporting the Congressman's observation that this is a subject that the public rightly finds unsatisfactory, and we do too. And although we have not made our final selections of those management problems, we will attack it in this first year or second year of the administration. I am prepared to guarantee you that erroneous payments will make the cut. The Comptroller's reports have highlighted this for quite some time, extrapolated to the whole government even conservatively, those findings would lead to a stunning amount of money now.

Granted, erroneous payments do include under as well as overpayments. Granted, that some care and caution has to be undertaken to make sure that reducing overpayments or mispayments does not so encumber the system that beneficiaries, rightful beneficiaries, are unduly penalized. But those observations cannot get in the way, I think, of an all-out assault on this area.

We have to—as regards this entire realm of management problems which my defense-minded friends would call a target-rich environment, you know, I think we have to be very, very selective, and that is the process we are about now.

I once heard Secretary George Shultz ask rhetorically, why does the Frenchman kiss the lady's hand? And his answer was, "Because he has to start somewhere." And you know, I think we have to be very mindful of the fact that we have to go after the big opportunities, not only for purposes of making sure we get something done, but I think also that we can learn from each experience and become better and more effective as we move on to the next and the next.

Mr. HORN. Let me give you two examples, and perhaps the Comptroller General can get into that one, too. The HCFA, the Health Care Financial Administration of Medicare—and the Comptroller General's team has looked at that for a long time, it has some real risk problems. We have intermediaries between the healthcare thing, we have the actual client and the doctors, and we really need to take a look at that, which nobody has done either up here or in the administration that I can recall.

My second example that worries me every year is the Columbus, OH Army operation where they are putting out processing of contracts and payments and so forth. They have just been off the wall. Now, I think they have improved it quite a bit and they are not completely off-the-wall anymore. But that is the kind of thing that can really cause difficulty when they don't have the right level of personnel, and that is part of the problem.

Go ahead, Mr. Walker.

Mr. WALKER. Well, first I think it is important to know what improper payments are and what they aren't. You know, in some cases, there are things that clearly are improper expenditures of taxpayer funds, where you are paying somebody who is deceased where you are paying twice, where you are paying for services that weren't rendered, etc. In some cases, they represent payments where there is a lack of adequate documentation, and you don't know whether or not it was a justified payment or not. But, I do think we can recognize that, whether you be in the public sector or the private sector, the whole principle that you must measure something in order to manage it. And therefore, one of the first things that we need to do is to try to measure these improper payments, have control mechanisms to try to avoid them.

One example is HCFA, the Health Care Financing Administration. We worked with them to come up with a methodology to measure estimated improper payments. They then began to take steps to manage them. Their improper payments have gone down from approximately \$23 billion in 1996 to about \$11.9 billion in fiscal year 2000; still too high, but that is considerable progress.

I think we also have to recognize that it is not just the systems and the controls, since we can have some perverse incentives. And one of the things that we are working with the Congress on, and this came up in the hearing before Chairman Shays, another subcommittee of this committee, we have some perverse incentives in the law. For example, there is something called the Prompt Payment Act, which says that if the Federal Government does not pay a payment within a certain number of days, the Federal Government has to pay interest. On the other hand, if there has been a double payment, under the current law the contractor doesn't have to tell you they have been paid twice; and, in fact, if they don't tell

you and they hold onto the money for a considerable period of time, they don't have to pay interest or penalty for having done that. That doesn't make a lot of sense to me.

Part of this comes back to our system where we have—where we need to have systems that can do data matching, and there are some issues there that we may need to look at, some possibly statutes, too, because of the privacy issues. There have been certain barriers that have been raised. Lots of times what we want to do is to do matching, match deceased lists against payments, and sometimes you run into barriers as to whether or not you are able to do that because of, “privacy concerns.”

So this is on our radar screen. I am encouraged to hear that Director Daniels is saying that this is going to make their shortlist. I hope our high-risk list also makes the shortlist, that would be one of the objectives, because I think that would be a real accomplishment as well. Thank you.

Mr. HORN. You mentioned the word “privacy,” and that is one of the questions I want to ask the Director.

The issue of privacy is obviously very important to the average citizen and to many of us here in Congress. Whether it is privacy with the Internet, in their homes, or in regard to medical records, people obviously don't want that put out in the public domain. As you are aware, Congress delegated to the previous administration the authority to develop and promulgate regulations relating to the medical privacy rules and, in fact, such rules were developed prior to the end of that administration.

I would like to know, and I think all of us up here would like to know, what is the administration's position on the medical privacy regulations that were developed by the previous administration? There are a number of privacy-related proposals floating around both the House and Senate, as well as in many committees with different jurisdictions.

When we put the Hutchinson bill through the Government Reform Committee, it went to the floor, and we had the popping out of different—the Commerce Committee in particular and others, and they said, oh, we will take care of it. Well, they haven't taken care of it for 5 years. And what we wanted to do was get the best brains that the President and the leaders of the Senate and the House could put together to see what the options were and what is happening in other parts of the world.

The European Community has mandated that its member countries will have a privacy law. Now, that is going to be a problem in the terms of economic data moving back across the Atlantic, and I have suggested to about four or five of the Prime Ministers over there, why don't you get a team of people, your CEOs in your firms in Europe and our CEOs in the United States, and get the impact of this before we do something crazy.

So I am just curious where we are on that, because it needs some coordination within the executive branch as well.

Mr. DANIELS. That regulation, proposed regulation, is under review, as you know, along with all of those which were inherited from the latter stages of the previous administration. And it is a matter of some urgency and high priority, and I think you can look forward to some action on it in the not-too-distant future.

There are a lot of interests to be balanced here. We got into this subject by talking about one of them, which is the occasional conflict between fiscal responsibility and accuracy and individual privacy, but there are other dimensions to the problem, as you know full well, in the health care, medical context; some privacy protective regulations that could frustrate another societal goal, which is medical research. It could even interfere with the clinical process and the patient's ultimate well-being.

So all of those things are being looked at very carefully. The paramount value I am sure that will be applied to that is individual privacy, but we have to make sure to find ways to protect that in a way that allows other important goals, such as care of the public dollar to proceed also.

Mr. HORN. Any thoughts, Mr. Walker?

Mr. WALKER. I do think it is important, Mr. Chairman, that in addition to protecting the privacy of individuals, that we also recognize that in order to make sure that we are minimizing improper payments and that we are fighting fraud, that does occur, especially in the healthcare industry. We have had a number of cases there. We have to make sure that there are mechanisms in place such that entities like the inspectors general and the GAO and those that are trying to safeguard the public's money have reasonable access to do things like data matching and to do analyses and investigations to try to make sure that taxpayer funds are only spent for bona fide expenses.

Mr. HORN. Let me pose another question here that a lot of us feel very strongly about. I don't expect you to really know this bill number, but it is H.R. 616 that would establish a separate Office for Management and Budget in the Executive Office of the President. The reason I advocate this change is that since assuming this chairmanship about 7 years ago, it was very clear to me, after dozens of hearings, and now 200 hearings, we have management issues that aren't being faced up. And that isn't a matter of party, it isn't a matter of liberal or conservative or anything else, it is simply the fact that when President Nixon put the M in OMB, I was an enthusiastic booster of that. I thought, "hey, this is great." We can use the budget to get their attention in Cabinet departments and deal with some of these management tasks.

My friends in the senior civil service over the last 5 or 6 years before I came here, they said, "Steve, you are kidding yourself." It isn't happening. The budget just squeezes out everything.

I think that is true, even though we have balanced budgets now, that we need to get a focus on the management. Y2K is one that everybody knows, that I started in April 1996. They weren't doing a thing. They had a system for management. Nothing ever was done there. The gentleman retired. Then years later, he was pulled out, made assistant to the President, and it worked. But you had to get focus on it, and there wasn't focus. They were 2 or 3 years behind.

And I just would like to get your thoughts on this. Should there be an Office of Management where you have somebody with the Comptroller General's background? That is exactly what we need in that spot, not a budget person, but someone who knows what big corporate operations are, big governments are, and how we could

better serve the people by performance budgets, as Mr. Putnam noted, and what they have done in New Zealand. I have taken a long look at that. It is worth looking at it.

Two socialist governments, in Australia and New Zealand, about the same time said, how are we going to get this job done? We can't pay the bills. We need to better know which programs are not working and get rid of those.

Now, in our country, Oregon comes to closest on this, South Carolina has been working on that, Minnesota has also been working on that. When we went to New Zealand to check what they were doing, they had followed Mrs. Thatcher's look at her own British Isles, and then they kept it going, and it still is, where Ambassadors have to account for everything, including the art on the walls.

A friend of mine who was an ambassador from New Zealand said, I am going to send the paintings back to them, they are not going to take in my budget. So you had to start to think about what do you do with the people's money.

So I would be interested to know what your feeling is on that.

Mr. DANIELS. My attitude for now, Mr. Chairman, is that I would not support that legislation, but I am not closed-minded to it, and I don't dispute for a moment your point that this has perhaps never been a sufficient priority in the past for either party. I would be willing to revisit my opinion on that question after some decent interval in which we will try very, very hard to realize the initial intent of assigning management responsibility to the same office that holds the purse strings, in a way, of the executive branch.

I would salute, and have in the past, the previous administration for taking one step, I think, in that direction by unifying within OMB budget and management responsibilities. That, at least in theory, brings together in one place the agency's resources directed at management, and its clout or its, let's say, persuasive interaction with departments and agencies at the budgetary level.

So my attitude is, though, what is important is that the job get done. And if we cannot make better progress under this scheme after some reasonable period of time, you will not find me territorial at all about this. I would worry that free-floating anywhere else in the government you wouldn't—this function would not be any better off, it wouldn't have any greater clout or any greater influence than, at least in theory, it can today.

I would say that I hope there is something—I won't forget the bill number—661 happens to be the number of billions of dollars that we have proposed in discretionary spending in this year's budget, and—

Mr. HORN. I won't say we are clairvoyant, but it is H.R. 616.

Mr. DANIELS. Well, it is not just a good mnemonic for me. Let me suggest another linkage.

One reason I think that management has been consistently crowded out over the last few years is that the budget process, as it happens in the Congress, between Congresses and administrations, has just grown, grown, grown until it is an almost 24/7, 365 day a year exercise. It has been so disorderly, so chaotic, so disrespectful of its own stated rules that it does devour the time of all concerned.

A major theme of President Bush's budget was to try to move back in the direction of an orderly budget process to live within the confines of the Budget Enforcement Act and perhaps to add a couple other reforms that might allow these basic decisions to be made in a more efficient way. If that happened, I guarantee you would have a major impact in terms of freeing our time and attention and resources to work on the rest of our assignments, starting with management.

My last observation is that we will take your counsel and study carefully some of these other examples of which I am only dimly aware: New Zealand, Australia and so forth. I would observe that these are all Parliamentary Systems, and I don't think it is entirely accidental, because I think you know from your experience that whatever the shortcomings of past administrations, of the executive branch, in managing its affairs, Congress plays a role too. Just as fiscal reforms and spending reforms tend to run into severe opposition in Congress, so do management reforms. And there are a number of them that we intend to advance, consolidation of agencies and of programs and so forth, that make eminent sense from a management standpoint but do collide with political realities, because they can't be done unilaterally the way I used to be able to do it in the corporate world.

Mr. HORN. I just suggest that perhaps on the strategic plans of these agencies, that we would—and I have told our own committee chairmen on authorization and the cardinals on the committees, that when we have that dialog, it ought not to be staff and staff; it ought to be the people the President has selected as reflecting his views; namely, you and others that are key people in making government work. We need on those, say, once-a-year affairs, to sit down around the table and talk to each other, those that are elected here to handle the budget through appropriations or whatever the authorizations are for policy matters. And I would just hope that we could get the right people around the table and then say, you know, that isn't the way we interpreted the law. Why don't you take a look at it?

I would like your—Comptroller General, I would like your views on the Office of Management, what you think. You have had some outstanding risk conflicts that you have put out with every new Congress, hopefully. I think that people will read them and do something about it. Well, we are trying to do that.

Mr. WALKER. From a conceptual standpoint, Mr. Chairman, I believe that it would be preferable to beef up the M in OMB, give it the amount of resources that it needs in order to do its job, for it to take the lead on strategic planning, financial management, information technology, and human capital on a government-wide basis, and the interrelationship, obviously, having to work with the Cabinet, with the deputy secretaries; obviously having to work with other parties such as OPM in the case of the people area. But, I think from an intellectual standpoint, that if they had the right players and enough resources, they would have the ability to be able to link and leverage the budget process.

I also would add that in addition to leveraging the budget process, something can and should be done quicker than that, and that is the issue of making sure that agencies have their performance

measurement and reward systems, not just for their executives, but cascading down to other fellow employees, also linked to the strategic plans and the outcomes that are desirable in the strategic plans.

We know that human beings will end up being motivated based upon how they are measured, and I think a vast majority of public servants are well-intentioned capable people who want to do a good job, and I think that we need to help them to be able to do that.

The last thing I would say, Mr. Chairman, is that I think because of the long-range fiscal challenges that I put up before on the boards, that now is the ideal time that government should be asking two fundamental questions. First, what should government do in the 21st century? And, how should government do business in the 21st century?

On the first, that I think calls for a fundamental reassessment of departments, agencies, and programs, obviously in some priority order, to ask the question: Why are they here? Why did we put them in place? Are the factors that caused them to be put in place still relevant? What priority are they for today and tomorrow, not for yesterday? That is going to take a cooperative effort between the legislative branch and the executive branch because, as Director Daniels said, you have to make sure you deal with both ends of Pennsylvania Avenue to get things done there.

On the other hand, on how government does business, making it more results-oriented, focused on outcomes that matter to the American people, maximizing performance and assuring accountability, I think OMB is in an ideal position to take the lead on that, working with the parties that I mentioned before, and obviously we will continue to try to play a constructive approach in trying to help get those kinds of results for the American people.

Mr. HORN. Well, I think your wisdom is very good and I am glad the Director will keep an open mind on this. It seems to me if you people could get together every couple of weeks, I think it would be worthwhile to have it happen. This is the one chance, when you get a new administration full of enthusiasm, to get things done. I think it will mean that you will be able to get people that want to help you, doing things the right way.

As I suggested, the kind of background the Comptroller General had is, to my judgment, exactly who ought to be the Director of an Office of Management. We had about a dozen or two during President Eisenhower's time. He was the first one that looked around the whole White House and Executive Office of the President to say, this place is just not staffed. He was used to vast forces, armies, whatnot, and he just couldn't believe what he saw. So he started to—President Truman put two people over in what is now the Eisenhower Building and said, look through the Congressional Record every day. That was the beginning of at least something down there.

And President Eisenhower put in an Office of Liaison with Congress, a good management group in the Bureau of the Budget at that time, who, if you wanted a law written or a corporate government function, which a number were, or working with the TVA, which all the line agencies up here hated and all that, but a lot of good things were done. They were done by able people without

a partisan lilt. They were just people that were excellent professionals.

And that is what we ought to get on this, people that are professionals, that will take direction. But we need people I think, like you do, to get people who can get things done, because otherwise nobody is going to face up to it. You need to get a good deputy secretary in most of these agencies, and that would certainly help, but they need coordination.

Mr. DANIELS. I couldn't agree more, Mr. Chairman. As you and I have discussed, we are searching for the best person, people, we can. In fact, we have, I think, set the specifications at a level that means it has taken a little time to find—to try to find the right leader and supporting cast.

I couldn't agree more that if we could get David Walker to take this on, then the problem would be two-thirds solved. He is one of the finest people in American government.

Mr. HORN. We could clone him.

Mr. WALKER. For the record, Mr. Chairman, I have a good job, but I appreciate the compliment. And cloning is illegal in the United States.

Mr. DANIELS. I know I would get shelled up here if I even attempted to steal him away from his congressional responsibilities. But we have visited on multiple occasions, and we have used his high-risk list as a starting point for our own target selection, and we will continue to do that.

He has his responsibilities which are not the same, we know, as ours; but there is this very strong convergence that you mentioned. And, to the limits of what is appropriate, I want the relationship between our two organizations to be tight.

Mr. HORN. Well, we thank you for coming. There are some other questions we might submit, if we could, from either the minority or the majority, that—some Members couldn't make it here.

So I want to now thank the staff that put many of these things together, and there is also a statement from Chairman Burton which will go into the record at this point.

I'd like to thank the staff for their work on this. J. Russell George, staff director and chief counsel, standing over there; Dianne Guensberg is a professional staff member, detailee from the General Accounting Office; Bonnie Heald, director of communications; Earl Pierce, professional staff; Matthew Ebert, policy advisor; Grant Newman, assistant to the committee; Bruan Homm, intern.

On the minority staff, Mark Stephenson, professional staff; Jean Gosa, minority clerk; and our two faithful court reporters, Bob Cochran and Julie Bryan. Thank you very much.

Mr. WALKER. Mr. Chairman, if I can, just before you put the gavel down, just for the record, I would like to publicly thank many of the GAO professionals who were part of the GAO financial statement audit. I hate to mention names, but just a few who are with me here today: Jeff Steinhoff, Gary Engel, Linda Calbom, Greg Kutz, Steve Sebastian, McCoy Williams, and Phil Calder are among the many dedicated GAO professionals that tried to make this happen; and, again, to mention the Treasury, OMB, and other public servants who also were part of this process.

Thank you, Mr. Chairman.

Mr. HORN. Well, we thank you, and their names will be in the record. If you would like to add some from the Treasury or the Office of Management and Budget we would be glad to put it in the hearing record.

Thank you very much.

[Whereupon, at 11:55 a.m., the subcommittee was adjourned.]

[The prepared statements of Hon. Dan Burton, Hon. Janice D. Schakowsky, and Paul O'Neill follow:]

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STATEMENT OF CHAIRMAN DAN BURTON
Committee on Government Reform
Oversight Hearing on the Federal Government's Consolidated Financial Statement
conducted by the Subcommittee on Government Efficiency, Financial Management and
Intergovernmental Relations
March 30, 2001

First, I would like to thank Chairman Horn for holding today's hearing focusing on the Federal Government's Consolidated Financial Statements. I commend Chairman Horn for his leadership in this area and for his commitment to Federal financial management practices. Oversight hearings, like this one, help to improve the quality of agencies' financial information and allow us to identify significant problems in agencies' operations and reporting.

I also would like to thank our distinguished panel of witnesses, which includes Comptroller General David Walker from the General Accounting Office (GAO), Mitch Daniels, Director of the Office of Management and Budget (OMB), and Donald Hammond, Acting Under Secretary for Domestic Finance, Department of the Treasury.

As you know, the Chief Financial Officers Act of 1990 (CFO Act) was enacted to strengthen the financial management practices of the Federal Government. The law established an infrastructure to support efforts to gain financial control of Government operations. The GAO has called the CFO Act the most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950 was enacted almost half a century ago.

The Chief Financial Officers Act as amended by the Government Management Reform Act of 1994, requires the Secretary of the Treasury, in coordination with the Director of the OMB, to prepare a Government-wide consolidated audited financial statement. The Comptroller General of the United States is required to conduct the audit of this statement. This Government-wide financial audit should give the taxpayers an idea of the financial status of their Federal Government.

Several departments and agencies have made great improvements when it comes to financial management. For the past fiscal year, 18 of the 24 largest departments and agencies received clean audit opinions. While this is an improvement, a clean audit opinion is only one indicator of sound financial health. Current law requires agencies to produce their financial

statements by March 1 of each year -- five months after the end of the fiscal year. Nevertheless, it is my understanding that it took tremendous efforts by most departments and agencies to meet this statutory reporting deadline. Agencies should be able to produce reliable financial information with greater frequency and with less effort. Agencies should also have financial management systems in place to allow them to provide timely information, which is complete, reliable, and consistent.

I thank our distinguished panel of witnesses for their dedication and service to this important issue. I am confident that the new Administration will provide the necessary leadership in this area. President Bush has made it clear that improving the financial management of our Federal government is a top priority. Congress, working with the Administration, is dedicated to ensuring that taxpayer dollars are not wasted and that agencies are able to accurately measure the full cost and performance of their programs.

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Opening Statement -- Rep. Janice D. Schakowsky
 Hearing on the Federal Government's Consolidated
 Financial Statements

March 30, 2001

Thank you Mr. Chairman.

Today we will hear testimony on the results of the fourth annual audit of the federal government's books, submitted today by the Administration and by the General Accounting Office. The audit, and the compilation of the consolidated financial statements, are a truly monumental task, requiring enormous data transmissions, unprecedented reconciliations, and the expenditure of significant time and resources. I want to commend our witnesses for accomplishing this task on time. I also want to commend the thousands of dedicated public servants at all of the federal agencies and at the GAO without whose efforts these reports would be impossible.

The consolidated financial audits represent a mile-stone in the effort to bring more financial accountability to the federal government. American taxpayers have the right to know when, where and how their tax dollars are spent. Successive administrations have embraced this principle, beginning with the passage of the Chief Financial Officers Act in 1990. In September 1993, the National Performance Review recommended the preparation of an annual consolidated financial report and the creation of comprehensive government-wide accounting standards. This idea was enacted into law in the Government Management Reform Act of 1994; passed, I might note, by a Democratic Congress and signed by a Democratic President.

The federal agencies have made steady progress toward achieving clean audit opinions over the decade since the implementation of these acts. Only 6 agencies received clean opinions on their financial statements for fiscal year 1996. That number rose to 11 in FY 1997, 12, in FY 1998, and 15 in FY 1999. Today it stands at 18. Only three agencies, Agriculture, Defense and the Agency for International Development, have received a disclaimer of opinion this year, with three others receiving qualified opinions.

Unfortunately, we have not seen as much progress in the consolidated financial statement audit for the entire federal government, and many of the problems of years past remain, particularly at the Department of Defense. This Subcommittee has been active in its oversight of

the financial management problems at the Department of Defense, and I commend the Chairman for his active pursuit of this issue. DoD has serious problems accounting for assets – property, inventory, and equipment. It has also continues to be unable to estimate the amount of liability faced from environmental clean-up costs and military post-retirement health care costs.

Mr. Chairman, ensuring sound financial management is not, and hopefully will not become, a partisan issue. Everyone supports the goal of sound financial management and real progress has been made in addressing this difficult problem. We need to be mindful of that progress, but clearly not yet satisfied, because much work remains to be done.

Thank you Mr. Chairman



DEPARTMENT OF THE TREASURY
WASHINGTON, D. C.

SECRETARY OF THE TREASURY

**For Release Upon Delivery
March 30, 2001**

**STATEMENT OF PAUL H. O'NEILL
Secretary
Department of the Treasury
TO THE HOUSE GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT
AND INTERGOVERNMENTAL RELATIONS
U. S. HOUSE OF REPRESENTATIVES**

March 30, 2001

**FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT
FISCAL YEAR 2000**

Mr. Chairman and members of the Subcommittee, I am pleased to submit a statement today on the Financial Report of the United States Government. I would like to thank you, Mr. Chairman, Ms. Schakowsky, and other members of the Subcommittee for focusing on improving Federal Government financial accountability and reporting.

While the fiscal year 2000 Financial Report meets the statutory deadline again this year, I believe that reporting financial results 6 months after the close of a fiscal year is simply not good enough. While incremental progress is being made each year by the Federal financial management community, incremental progress will not move us forward quickly enough to close what I see as the gap between the current state of financial management and a condition that would adequately meet our responsibilities to the American people.

I believe that we need to establish some challenging objectives for governmental financial management; objectives that parallel those found in the private sector that will force people to think creatively. We should start with the amount of time it takes to close our books. When I was in the private sector, we closed the books and had an audit opinion in 3 working days. We need the Government to establish a similar goal. This will force Government to look at the closing process differently than it does today. It will require transaction-based systems to produce the reports, instead of the after-the-fact accounting we utilize today. It will also require the establishment of more frequent agency reporting. In short, it will go a long way toward making Governmental accounting more useful, both to agency management and to Congress by improving the quality of the data.

In order to achieve this goal, we need to work together as a government. Treasury can lead this effort, but the agencies are the key to success. We need to do 3 things now. First, we need agencies to identify short-term process improvements to reduce the closing time. Second, in the longer term, we need to reexamine our overall financial management process to look for ways changes to our systems can help. Finally, Treasury, in conjunction with the Office of Management and Budget (OMB) and the General Accounting Office (GAO), will conduct a comprehensive review of the financial statement production process to establish the specific goals for the timing of future financial reporting and to build goals for the content of the reports so that they will become more meaningful.

I want to emphasize one previous point. We must expand the audience for our reports by making them more useful. Looking through this year's report I see a number of ways that it could be improved. First, it has too much information in many areas and not enough in others. No one will take the time to wade through all this supplementary data. The report needs to be put on a serious diet. Second, all reports need a reference point. Financial statements without comparative results are meaningless. We need to add last year's amounts to our reports. Third, we need to find ways to include detail schedules to show the financial results of each component unit. Finally, the Government should directly track and report agency progress toward meeting important financial management goals in areas such as internal controls, and transaction processing.

I believe that the work that has been done to date is valuable and is an important starting point. Together we should improve these reports to become more useful both within the Executive Branch management and to Congress. Mr. Hammond's statement addresses many of our challenges and concerns in greater detail.

